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BusinessWeek

7, 2001

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JAPAN'S REFORMER

The new Premier
has a radical
plan to fix
the economy.
Does he
have a
fighting
chance?

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PRIME MINISTER
JUNICHIRO
KOIZUMI



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JAPAN'S REFORMER

Can firebrand Junichiro Koizumi survive in office long enough to push through the changes he's promising? page 96



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Kicking the tires on a pack of sharp new offerings page 124

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Finally, there's a glimmer of hope for the dysfunctional \$4.5 trillion Japanese economy. New Prime Minister Junichiro Koizumi has a radical plan to cap government spending, privatize postal savings, and police the banks. But with his Liberal Democrats facing voters this summer, he has to move fast. Every action will be scrutinized by a global audience, since, with the U.S. economy limping, the world cannot afford more chaos in Japan. Does Koizumi have a fighting chance?

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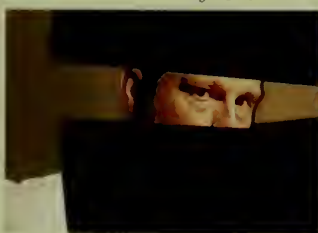
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The BusinessWeek



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Phase Two

First, the Net meltdown claimed smaller dot-coms. Now, the sheer scale of broader failures is hitting even tech giants.



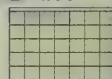
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BUSH 2001



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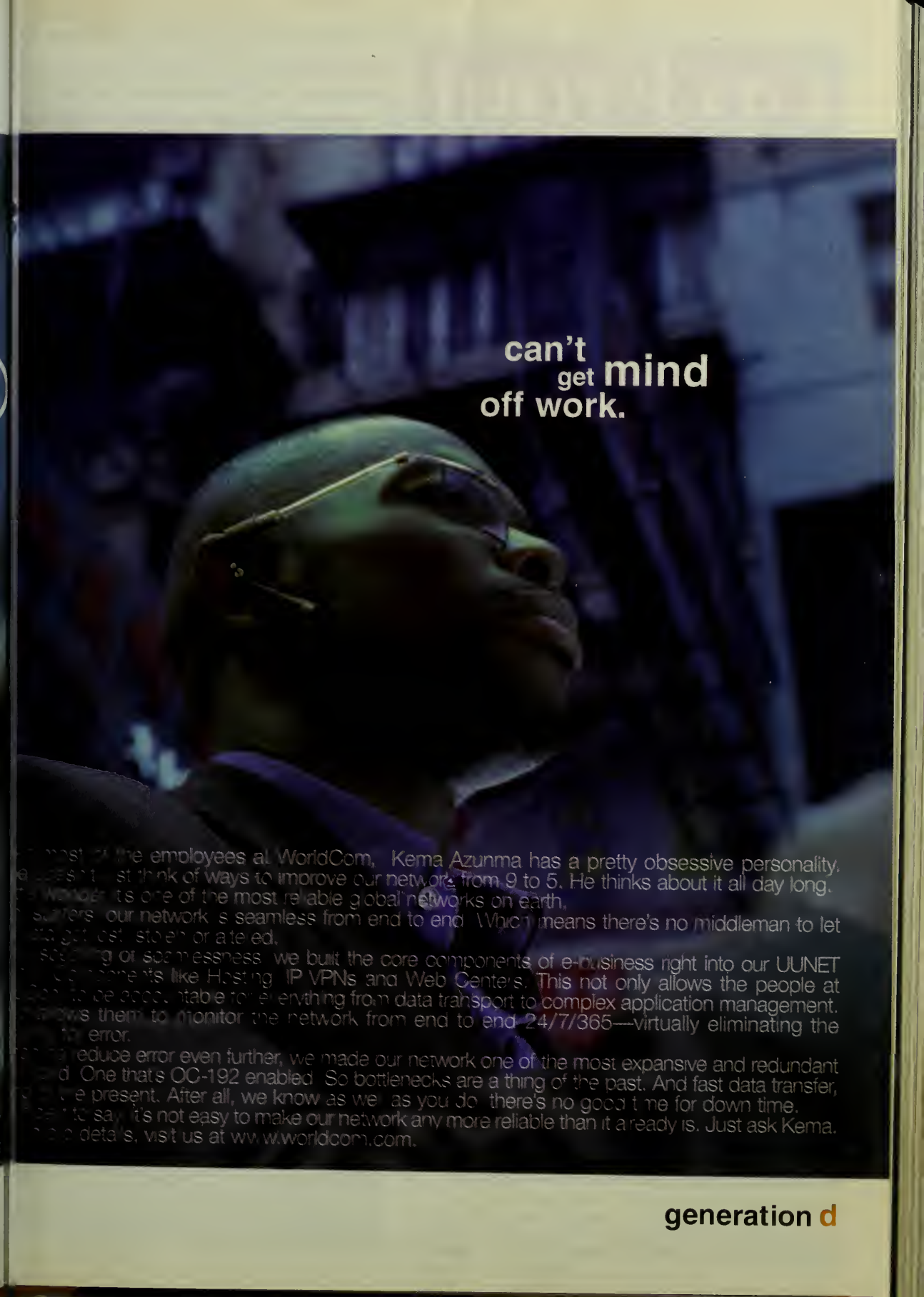
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generation **d**

Up Front

EDITED BY SHERIDAN PRASSO

FALLING AXES

LOWERING THE BOOM ON SUMMER HIRES

HERE'S ONE MORE CASUALTY of the economic downturn: summer hires. For the past decade, old-line manufacturers, service-sector giants, and denizens of the New Economy have hired roughly 2 million young people—generally students—to fill in for vacationing employees or to do seasonal work every summer.

Not this year. Calls to a number of companies find they're scaling back or eliminating summer jobs altogether. Tens of thousands are likely to be affected nationwide.



Among them: 3M, Intel, Mercer Management, Gannett, R.R. Donnelley & Sons, and Dell. Motorola, which last summer hired 2,000 college students, will take on fewer than 1,000 after reporting its first operating loss since 1985 and announcing layoffs of up to 25,000. Steelcase, a maker of office-furnishings, won't take on its usual 350 college students, either. "I'm not proud of this," says CEO James Hackett, who adds that it's the only way to ensure enough work for current employees.

Memo to young people hunting for summer jobs: You may still get work this year, but it will be much, much harder. *Michael Arndt*

PAPER PLAYS

AN 'OVERHANG-OVER' IN SILICON VALLEY

WHEN SILICON VALLEY WAS booming, tech companies handed out stock options like breath mints. Now they have a bad taste in their mouths.



CISCO'S CHAMBERS: Options as far as the eye can see

A new study by benefits consulting firm Watson Wyatt Worldwide finds that the tech companies with the biggest "overhang" of unexercised stock options had the worst stock market performance

from February, 2000, through January, 2001. While Watson Wyatt isn't naming names, it's a good bet that losers included options-heavy Microsoft, whose stock fell 38% in that period, and Cisco Systems, which fell 32%.

Investors dislike lots of overhang, which consists of unexercised options plus those that have been authorized but not yet granted. When options are exercised, existing shares are diluted. (Under CEO John Chambers, Cisco's overhang of 1.4 billion options in July, 1999, equalled more than a third of outstanding shares.)

Of the 70 tech companies studied, those with too much overhang fell by 45%. Those with too little—meaning they underused options—fell by 21%. Tech companies in the "sweet spot"—with an overhang of around 26% of outstanding shares—actually went up 4%. *Peter Coy*

TALK SHOW "They put the Mississippi River on Nasdaq, mississippi.com, and it went right down, way down"

—Garrison Keillor, commenting on the flooding on his radio show, *A Prairie Home Companion*

CAR TALK

A RISKY MASS-MARKET MOVE FOR THE PT

WILL CHRYSLER'S PT CRUISER still be as trendy if it becomes as common as a Honda Civic?

Executives at Daimler-Chrysler apparently think so. After selling out all 175,000 models made since last spring, and then some (there's a months-long waiting list), they've decided to expand production of the retro hot rod by 80,000 units next year. That will bring worldwide manufacturing capacity to 310,000 vehicles per year. Chrysler execs say extra production will make it easier to build spin-offs such as the new convertible, a panel van, and maybe even a pickup—and keep the PT's buzz going.

But analysts question the strategy, wondering whether Chrysler will dilute the car's

hard-to-get coolness putting too many of them on the road. "This is sure to be a fashion statement. You don't want to flood the market with as many as we can build," says Wes



SPIN CITY: A topless spin-off of Chrysler's hit is coming

market researcher for the trend. After all, the Volkswagen Beetle, another style statement that was hard to get, too, only aged about 83,400 sales in 1999 peak.

But for a company struggling with deficits and falling sales for most of its other products, maybe such a bad idea to see what works. *Jep*

THE LIST KEEPING IT ALL IN THE FAMILY

When Disney acquired ABC in 1996, CEO Michael Eisner envisioned a media, film, and publishing empire. Now, five years later, comes the clearest example of that yet in *Ice Bound*, the story of Dr. Jerri Nielsen, who was stranded in Antarctica, had to perform her own breast cancer chemotherapy, and lived to tell her tale.

The following Disney companies control:



ICE WOMAN: NIELSEN

	THE BOOK	Talk Miramax Books	January
	MEDIA INTERVIEWS*	ABC's <i>Good Morning America</i> and <i>PrimeTime Thursday</i>	January
	THE BOOK EXCERPT	Talk magazine	February
	THE MOVIE	Miramax Films	No date

* ABC News said it had no special access to Nielsen. She subsequently did an interview with NBC's *Today Show*. Data. Fairness & Accuracy in Reporting



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Up Front

RED FACES

THE MONEY ADVISERS WHO WENT BROKE

WHEN THE EVERYWOMAN'S Money Conference began nearly three years ago, it seemed like a great idea.

Founders Jody Temple-White, an Oregon financial planner, and author/artist Jan Black figured women were eager for financial advice, but not the boring kind.

So they organized splashy financial seminars around the country featuring high-profile money experts and celebrities such as Debbie Reynolds, Naomi Judd, and Linda Ellerbee. To pay for the 14 events—free to the more than 20,000 women who attended in eight states—the duo raised funds from corporate sponsors and others.



But in the ultimate irony, Everywoman's Money Conference fumbled its own money. It shut down in March, unable to pay its bills. The founders say the business climate became too difficult and that they became mired in credit-card debt. Now, says

Temple-White, "we can teach women what not to do."

What happened? "They tried to do too many things at once," says conference speaker Dee Lee, who is still owed fees. In addition to one-day conferences,

the group held smaller follow-ups, ran a Web site, and launched a book series. Adds financial planner Avis Pohl: "Their passion was to help women manage money rather than to make money themselves." Just too bad they didn't heed their own advice. *Susan Scherreik*

MAD AVENUE

LOOK HOMEWARD, BROADCASTER

THINK OF LOCAL TELEVISION commercials and you might recall the schlocky old spots featuring used-car salesmen in plaid jackets screaming into a wobbly camera about "Deals! Deals!! Deals!!!"

Deals!!!

they'll get the best bang for their buck on TV.

The reason? They need to make up for a shortfall. National spot advertising in the country's 210 TV markets plunged 20% in the first quarter from a year ago as companies cut back on blanket advertising affiliates with the same ads. In Detroit, for example, last year's mix of TV ad revenues in the first quarter was 45% local, 55% national. This

year, that has shifted to 62% local, 38% national. Says Thom Porterfield, general sales manager of Fox affiliate WTIC in Hartford: "With local businesses, you can build a relationship, and trust."

With TV ads expected to be down 10% this year, you can bet station salespeople will be scouring Main Street and the shopping malls of America. *Tom Lowry*

And with the worst advertising downturn in a decade, TV stations are becoming more aggressive about courting these local advertisers. Their tactics include hiring hundreds of salespeople to convince local companies

FOOTNOTES Companies that did IPOs of at least \$10 million in the first quarter of 2001: **17**; in first-quarter 2000: **142**

DRAWN & QUARTERED



NAFTAMATH

YANQUI TIME, GO HOME!

IN MEXICO, EVEN THE TIME OF day can cause a political ruckus. Daylight savings time kicks in on May 6 this year—one month late. The new date is President Vicente Fox's compromise in reaction to howls of protest against summer time, in effect only since 1996.

Its opponents harbor the suspicion that Mexico adopted daylight savings to be more like the U.S. (Since Mexico is the U.S.'s second-largest trading partner, it certainly helps to be in sync.) They complain it throws off their biological clocks, forces kids to go to school in the

dark, and doesn't cut electricity bills. Data showing it has saved seven weeks' of total household electricity consumption doesn't enter their minds.

So Fox shot the period two months—two than the U.S. so, Andrés López of Mexico City brand mayors declared the exempt. On the Supreme intervened, Mexico City into come in order to avoid "international repercussions to mention *mucha* com *Elisabeth*



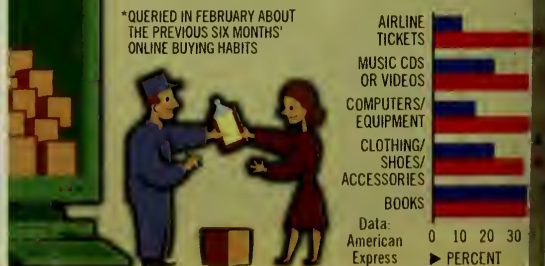
MEXICO CITY: Not saving daylight

THE BIG PICTURE

ONLINE BUYING RISES YEAR-OVER-YEAR

A Web-based survey of 800 consumers* finds they buy more online than they did in the same period a year earlier.

*QUERIED IN FEBRUARY ABOUT THE PREVIOUS SIX MONTHS' ONLINE BUYING HABITS



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BJC-85 Bubble Jet Printer.

and all three have a built-in IrDA interface that allows convenient wireless printing from compatible computers and handheld organizers.* They all deliver stunning 720 x 360 dpi prints at 5 ppm black and 2 ppm color.

At a little over 2 lbs., the BJC-50 and BJC-55 printers just beg to be slipped into that extra pocket in your laptop bag. Also, the BJC-85 printer offers continuous printing with a built-in, 30-sheet paper tray.

And just when you think it can't get any better, these compact printers can transform themselves into color scanners with Canon's exclusive, optional IS-12 Color Image Scanner cartridge.**

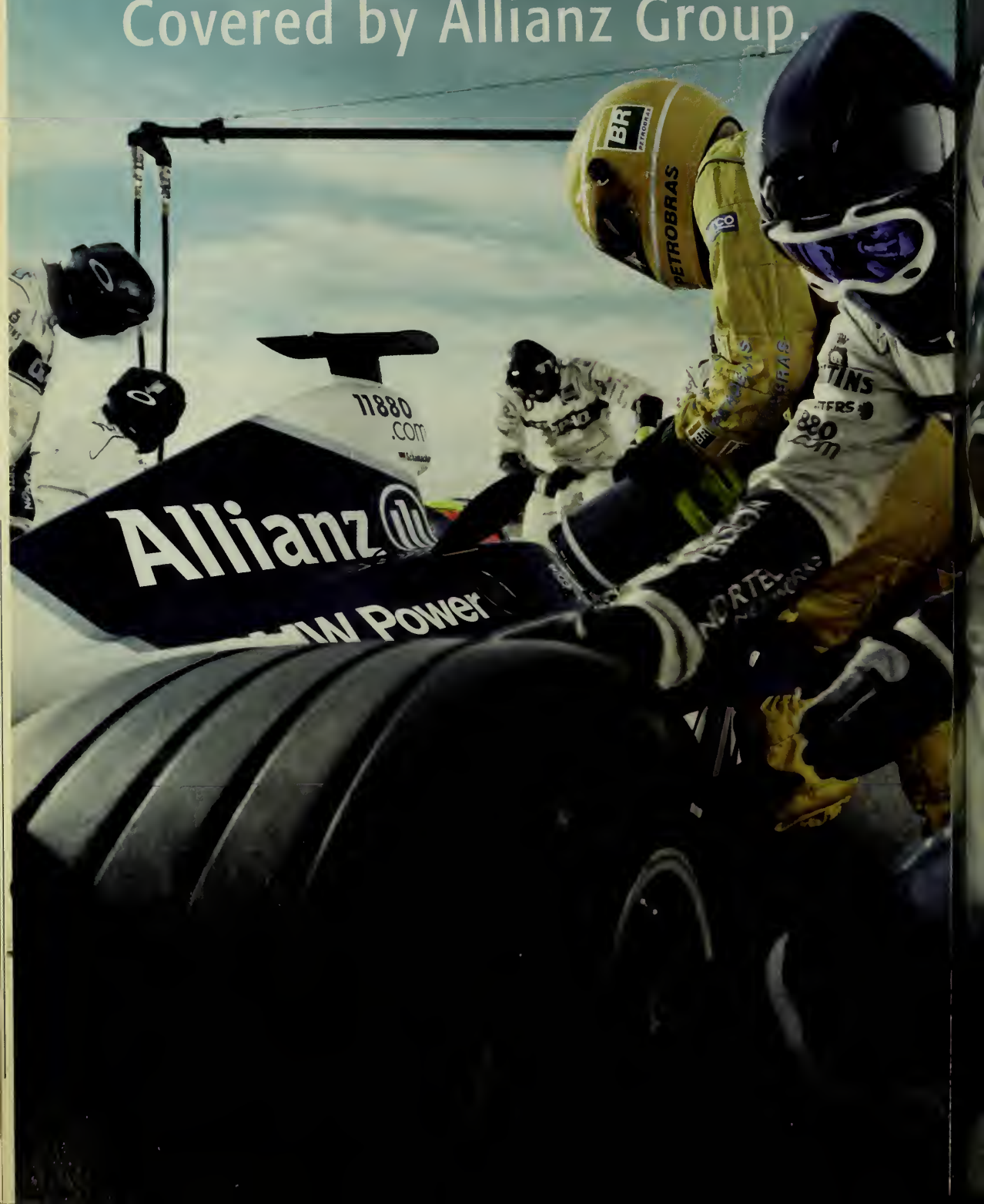
But the important thing to remember is that they're all from the #1 name in portable printers.† So whichever you choose, you have made the right choice. It's technology that makes sense. Visit www.usa.canon.com/consumer or call 1-800-OK-CANON.

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CHINA: AGGRESSOR OR VICTIM?

"China: Coping with its new power," (Cover Story, Apr. 16) seems trapped in the cold war myth that only communist societies are a threat. This underestimates the power of capitalism, which has been the engine of most of modern history's great powers and empires. The Soviet Union as a great power was an anomaly. The largest, global empire of modern times was Britain, the model of democratic capitalism. And it was a very capitalist America that became a superpower. Imperial Japan and the Germany of kaiser and führer had capitalist economies. The lesson of history is: More wealth brings more war, as regimes find the resources to pursue new ambitions and settle old scores.

William R. Hawkins
 U.S. Business & Industry Council
 Washington

I can't help but wonder why you fail to see the real danger [from China]. A military confrontation between China and the U.S. is not a remote possibility but almost a certainty. China has strong expansionist aims in the Pacific area, and this directly collides with U.S. interests there. It is also a completely repressive state that will have no scruples whatsoever in nationalizing all Western property when it feels that this best suits its interests. The best advice anyone could give Western CEOs is to keep this scenario in mind when contemplating an investment in China.

Michael Stein
 Flechtorf, Germany

You write that "Chinese Internationals are full of anti-U.S. hate" (Apr. 16). The main reason for the unending meddling on the part of the U.S. in the internal affairs of China and the ceaseless harassments of the U.S. of the Chinese under the guise of defending democracy, human rights, while their real design is to create states to China's detriment.

I am a French citizen, born to Chinese parents and living in France. I fully support the Chinese regime that is doing its utmost to end the Chinese people's poverty and underdevelopment. The U.S. must stop bullying the Chinese people and respect the country's sovereignty.

Laurent
 Villejuif, France

LINING UP TO SAY EXECUTIVE PAY IS OUT OF LINE

I found the article on "Executive Pay" (Special Report, Apr. 16) disgusting. How can a person who works for a company and fellow workers go on strike and still demand and/or accept compensation for himself?

John A. H.
 Fort Lauderdale, Fla.

Your report on executive pay demonstrates why the drive to do away with estate taxes is misguided. Very few people are paid over \$100 million a year; we must protect society from generations of useless "aristocrats" springing. The propaganda in Congress about family farms and small businesses is a lie. There are other ways to protect the middle class. Your article makes an excellent case for that.

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MAY 7, 2001 (ISSN 0007-7135) * 3731**
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 Executive, Editorial, Circulation, and Advertising Offices: The McGraw-Hill Companies Building, 1221 Avenue of the Americas, New York, N.Y. 10020. Telephone: 212-512-2000. Telex: Domestic 212039; Intl. 230412039. U.S. subscription price: \$54.95 per year; \$79.95; \$99.95. Single copies: 10¢ each. Postage paid at New York, N.Y., and at additional mailing offices. Postage paid at Montreal, P.Q. Canada Post International Publications Mail Product Sales Agreement No. 248464

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CORRECTIONS & CLARIFICATIONS

In "The Bloomberg Machine" (Cover Story, Apr. 23), a table of financial data service providers should have said that ILX Systems has 160,000 screens leased.

in fact, for a big increase in the marginal income tax for very large incomes.

Robert I. Weil
Villanova, Pa.

We see once again how far executive compensation has gotten out of line, even at companies where growth in long-term shareowner value has been above average. As an investor, it is encouraging to see a few companies like Biomet Inc.—whose president and CEO, Dane A. Miller, year after year produces real shareowner value at reasonable compensation.

Edward Singletary
Washington

ARE THE BUSINESSWEEK 50 MASTERS OR FLUKES?

"Masters of Innovation" (The BusinessWeek 50, Spring 2001 Bonus Issue) cites Bell Labs, circa 1950, as one traditional model of innovation. Bell Laboratories, now the research & development arm of Lucent Technologies Inc., has come a long way since then in our approach to nurturing innovation. There used to be a number of layers between Bell Labs and the customer. That's no longer the case. Now, development teams work directly with customers during the design phase. Also, we often now use customer networks to beta-test new products before we consider them final. The model seems to be working: Bell Labs innovations are making the journey from lab to market faster than ever, and we earn more than four patents per work day.

Arun Netravali
President
Bell Labs
Murray Hill, N.J.

The BusinessWeek 50 should be renamed "The Lucky 50." Of the top 50 companies in 2000, only 13 made it again in 2001. While this is statistically significantly different from a random draw, one has to wonder about the usefulness of such a ranking to your readers whose faces are not in the magazine. I find it very difficult to believe that so many so-called "top" companies can fall from grace within just one year. Are the fun-

damentals of corporations really that volatile or is your ranking merely a reflection of the stock returns?

Shou Wang
Ithaca, N.Y.

INFORMATION SUPERHIGHWAY ROBBERY

Congratulations on your exposé of how VCs and big financial service firms perpetrated the greatest fleecing of the public at large in the history of the nation ("The great Internet money game," BusinessWeek e.biz, Apr. 16). It was a simple and proven boiler room scheme: create a shell, get the respectable names behind it, hype it, and unload it on the suckers. If the Merrills and the Goldmans of the world believed these companies to be the great investments their "analysts" proclaimed them to be, then how many shares of these companies did they buy or accumulate? Pity Henry Blodget and the rest. What were they to do? Not rob the people who left their wallets unlocked?

David Anton
New York

TOUGH COMPETITION: 1.5 BILLION WORKERS AT \$2 A DAY

Don't bet on the Free Trade Area of the Americas. Quebec is just the opening skirmish ("Business winces as Bush fumbles on trade," Washington Outlook, Apr. 16). I don't see the need to compete with another 500 million people working for \$2 per day in Latin and South America. After all, I already have to compete with 1 billion Chinese working for \$2 per day.

Rich Cree
Columbus, Ohio

IS YOUR PRIVACY SAFE IF THEY SAY IT IS?

Not only is consumer financial information being distributed, so is their medical privacy information ("Think your secrets are safe?" Finance, Apr. 9). Because of the Gramm-Leach-Bliley Act of 1999, financial institutions and insurance companies are exchanging consumer information. Now, when the consumer applies for a home mortgage or a car loan, the financial institution will not only have the credit information, but health insurance information as well.

C.J. Braun
Houston

Property and casualty insurers take the personal privacy of our policyholders

and other consumers seriously. We our customers and understand the desire to protect their privacy. Why we want them to be aware of protections afforded by the new civil-services modernization law. Come the new law's consumer protections and would like, once again, strongly recommend that consumers pay attention to the new set of rights now enjoy.

Robert E. [unclear]
Pres.
American Insurance [unclear]
Wash. [unclear]

A BRONX CHEER FOR A DATED METAPHOR

Nicholas P. Heymann, the Financial Securities Inc. analyst, was creative in using the imagery of a mobile chop shop in the Bronx. "GE-Honeywell: How Jack stole the show" (The Corporation, Apr. 16). The company has had much success since its wide-known nadir of the mid '70s. Hundreds of businesses with thousands of jobs have expanded within only a few miles to the Bronx, more than 40,000 new housing have been renovated or built, and the hometown ball team won a few World Series.

Michael [unclear]
Riverdale, N.Y.

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SHADOW OF THE SUN
Ryszard Kapuscinski
• 325pp • \$25

THE GRAVES ARE NOT YET FULL
By Bill Berkeley
Basic Books • 309pp • \$27.50

IN THE FOOTSTEPS OF MR. KURTZ
By Michela Wrong
HarperCollins • 338pp • \$26

HAT WILL AFRICANS MAKE OF AFRICA?

Although the rest of the world may not realize it, this is a crucial era in Africa's long, fraught journey into modernity. Colonialism and civil wars are gone. White rule in Africa, the final holdout, is of a decade behind us. Africa is new again for the first time in well over a century. What are its roughly 1 billion inhabitants going to make of it? What hold will the past exert as we endeavor to build a freer, better future? And how should we who are not African understand all the drama of this time in the remaking?

These questions lie at the core of three books under review. But the similarities end. Ryszard Kapuscinski's *The Shadow of the Sun* is an engaging close-up filled with landscapes, rutted roads, and the perils of African life. Bill Berkeley's *The Graves Are Not Yet Full*, is less a journey through the continent than a hard analysis of historical and political factors behind the tragic tyrannies—the Geras, Liberias, and Sudans—of the decade. Then there is Michela Wrong's *In the Footsteps of Mr. Kurtz*.

While she purports to recount the rise and collapse of Mobutu Sese Seko in the Congo (now the Congo Republic), Wrong never leaves her native England. Her book, condescending and uncomprehending at once, is filled with the very misapprehensions that Kapuscinski and Berkeley are at pains to take us beyond.

Kapuscinski, a Polish journalist who lived in Africa in 1957, long ago distinguished himself as one of the

great correspondents of his generation. In books such as *Imperium* (on the collapsed Soviet Union) and *Shah of Shahs* (on post-Pahlavi Iran), he has explored that sliver of high, thinly populated ground on which journalism and literature are occasionally joined. So he does again in his new book, a distillation of 40-odd years of return visits to Africa. This is not Kapuscinski's best effort: The enormity of the subject lends this book a sketchy feel. But a near miss by this writer still leaves him striding ahead of other correspondents who seek the benediction of hard covers.

Kapuscinski identifies the challenge right from the start. "Only with the greatest simplification, for the sake of convenience, can we say 'Africa,'" he writes in his forward. Fair enough: There are many Africas, and Kapuscinski is altogether enthralling as he guides us through them—by bus,

boat, Land Rover, and bush plane. He skips the strongmen, the corruption, and the coups that make the news—that's only background to him. Kapuscinski's Africa is the continent of village pathways, roadside tailors, millet beer, baobab trees, and huts shared with cobras.

As in his other books, Kapuscinski's method here rests upon the dilated detail, the fleeting moment explored for all it's worth. A group of Ugandans glimpsed carrying a stricken villager furtively through the jungle night prompts a marvelous exegesis on witchcraft, spells, and sorcery. In Zanzibar in 1964, a coffee vendor sounds

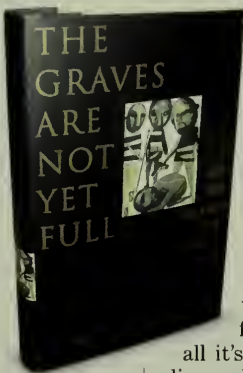
his bell calling customers at dawn a few days after a coup (which eventually joined the island to Tanganyika to form Tanzania). This produces a discourse on the often-observed resilience of Africa's struggling millions and the way "normality and dailiness" flow back over events with the inevitability of tides.

"Ordinary people here treat political cataclysms...as phenomena belonging to the realm of nature," Kapuscinski writes. "One must simply wait them out, hiding under the roof, peering out from time to time to observe the sky—has the lightning ceased, are the clouds departing? If yes, then one can step outside again and

resume that which was momentarily interrupted—work, a journey, sitting in the sun."

Time, hunger, work; waiting, belonging, fetching water; day and night, sun and shade, rain and drought: You finish this book with a grasp of how much such ordinary things mean to Africans, and therein lies its reward. Bill Berkeley, by contrast, is a reporter whose humanity, while equally evident, takes a different form. An American who spent a decade freelancing in Africa, he's looking to comprehend the violence that has thrust the African hot spots of the post-cold-war years into headlines around the world. *The Graves Are Not Yet Full* is a book with an intellectual argument, and it is well and forcefully made.

Berkeley's title comes verbatim from an exhortation on Rwandan state radio urging the Hutu majority to finish off the minority Tutsi. We've all read about the massacres that ensued in 1994. "How is such a horror possible?" Berkeley asks a Hutu sorghum farmer



WITH THE COLD WAR AND WHITE RULE PAST, THE CONTINENT'S FATE IS FINALLY IN ITS OWN HANDS

Books

who overnight turned into a murderer of neighbors. It's Berkeley's central query. In answering it, he is intent upon countering the orthodoxies that put such tragedies down simply to tribal rivalries, primitivism, or some sort of savagery lurking in the African soul. "This book is intended in part as a pointed rebuttal to that sort of nonsense," Berkeley writes.

I like the pugilistic stance. Berkeley doesn't deny the force of tribalism, but he wants us to see it in its complex, historic context. He explains that the colonial era exacerbated ethnic differences—sometimes purposely, sometimes not. Tribalism, he says, "became a dominant mode of political life in Africa in the major slaving years... when the existing states either failed to defend citizens from violence and enslavement or collaborated with the slave traders." It was a means of self-defense.

Americans are meant to see themselves in the current mess, too. Berkeley takes particular aim at cold war-

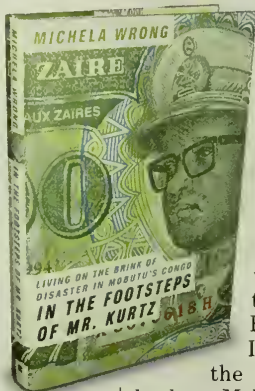
riors such as Chester A. Crocker, President Reagan's point man on Africa, whose apologies for gruesome dictators prolonged the old problems. "My own experience across the continent," he writes, "has taught me that Africans in ever greater numbers favor racial and ethnic tolerance, the rule of law, and the sanctity of individual rights."

Berkeley makes no leap from journalistic to lyrical writing, as Kapuscinski does: His is a straight up and down account with few flourishes. It makes us view things differently, though, and that makes Berkeley's book worthwhile.

It's a shame one can't say the same of Michela Wrong's

book on Mobutu's Zaire.

This is rich material gone to waste. In *The Footsteps of Mr. Kurtz*—the title of course makes reference to Conrad's crazed character in *Heart of Darkness*—amounts to little more than the leftovers dished from a news gatherer's notebooks, garnished with tasteless attempts at wit and with a Perils-



of-Pauline sense of self-dramatiz-

You anticipate trouble when V starts out poking fun at Mobutu's leopardskin caps—and goes on to critique the rest of his wardrobe, including gaudy furniture. She is simply too hating up her skirts and describing shock and disgust to truly set foot in Africa. Her first chapter, which starts to concern the pitfalls of life at the shasha Intercontinental Hotel, where Wrong seems to have spent many of her days. In 338 pages, you do not get to know a single ordinary African. Who does Wrong interview when she visits a copper mine in Katanga province? An old Belgian miner, naturally.

It's a poor performance, and Wrong seems wholly unaware of the perspective she advances. That's why the book is oddly instructive: Tribalism has passed, Wrong reminds us, but the attitudes it shaped live on. These reflexes are also books such as Kapuscinski's and Berkeley's are to be especially welcome.

BY PATRICK S.

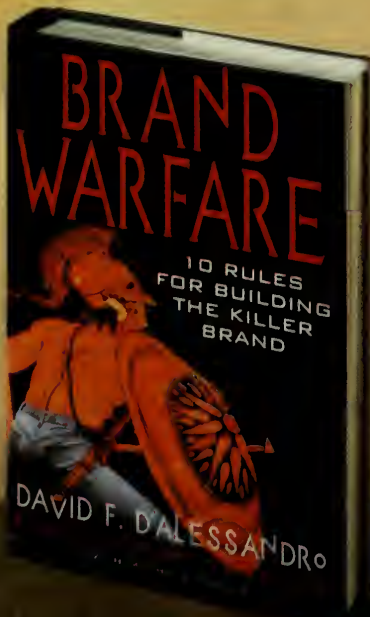
Smith is at work on a book about America's place in the post-colonial world.

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Of course not.



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BY STEPHEN H. WILDSTROM

tech&you@businessweek.com

DVDs AREN'T READY FOR HOME MOVIES YET



A promising consumer technology is hobbled by too many formats, too little equipment

I have finally achieved convergence. After wrapping up a video of a trip to Hawaii using Apple's iMovie 2 editing software, I clicked a button that saved the movie for Apple's new iDVD program, then fired up that application and "burned" a disk. I popped the DVD out of a Macintosh and into a Sony DVD player, and the movie appeared on my TV set with all the quality of the digital video original. The good news is that it was just that simple. The bad news is that the chances that you will be able to do this anytime soon are not very good.

Few consumer technologies have had as painful a gestation as recordable DVDs. And the struggle won't end just because the first drives, made by Pioneer, are finally shipping in a \$3,500 Power Mac G4 from Apple and a \$2,300 Presario 7000 from Compaq. No less than four recordable DVD formats are being promoted by different companies and coalitions, confusing people and impeding development of the volume market that would make the technology affordable.

What consumers need is very simple. DVDs, like CDs, are great for storing data: documents, pictures, video clips, or digital music. They hold 4.7 gigabytes, the equivalent of nearly seven CDs. But their most promising use is video production. So a DVD writer should produce disks that can be read in both computer drives and standard DVD players.

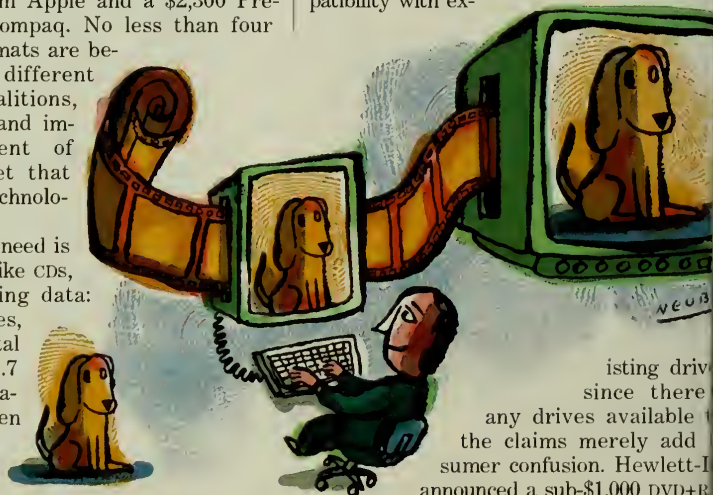
Apple's software makes it simple for anyone who can string camcorder shots into a home movie to convert it to DVD format. There's a lot more work to do on the Windows side. The Pinnacle Systems Studio DV editing software chosen by Compaq is fine. But Pinnacle's DVdit LE program was designed for professional producers. While it offers many more options than Apple's iDVD, it is orders of magnitude harder to use.

LIMITED SUPPLY. The software will get better. I'm less hopeful that the computer and consumer electronics industries will end a long-running feud over recordable DVD formats. The Pioneer DVD-R drives only let a disk be written

once—an approach that has proved popular in the CD field, where write-once disks cost less than 50¢ apiece. The cost of blank DVD-Rs is currently up to \$20 apiece, should drop dramatically once mass production starts. But firm demand will have to increase substantially. For the time being, DVD recorders will remain scarce. Apple and Compaq have bought up most of this year's production of the Pioneer DVD-R drive, which can also read and write CDs. Large quantities of the drives alone will go on sale in May for about \$850.

Computer manufacturers seem committed to the notion of rewriteable disks. But they've had a terrible time bringing the drives to market. Currently, you can buy something called DVD-RAM, sold under assorted brand names and made mainly by Panasonic. Drives start at about \$500, and disks cost around \$25. Trouble is, DVD-RAM disks can't be read by DVD players, making them useful mostly for backup and for offline storage of very large files, such as digitized video.

PROMISES, PROMISES. Two other rewriteable formats, known confusingly as DVD+RW and DVD-RW, are being pushed by coalitions of computer and consumer-electronics companies. Each claims to offer the greatest degree of compatibility with ex-



isting drives since there are already many drives available. The claims merely add to the consumer confusion. Hewlett-Packard announced a sub-\$1,000 DVD+RW drive in January but has not brought it to market yet, and it is not clear when these drives will appear. Meanwhile, an industry group called the Optical Storage Technology Assn. promotes a standard called MultiRead that will allow drives to read a wide variety of CD and DVD formats. Even if it works, however, it would take the millions of consumers who already own DVD-compatible DVD readers.

As the Pioneer CD-R drive and the simple Apple software show, this could be an important consumer product. But we're not about an industry that can't agree on a standard DVD stands for "digital video drive" or "versatile drive." Given the sorry past and I'm not optimistic that many consumers will see this technology anytime soon.

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BY ROBERT J. BARRO

ARGENTINA'S CAVALLO MAY NOT PLAY THE HERO THIS TIME



PUZZLING: Cavallo saved the economy in 1991. But his new plan focuses on raising confidence without taking the tough steps required

In the early years of the 20th century, Argentina was one of the richest countries in the world. Then came many years of failed policies, and Argentina retreated to the status of a middle-income country. From 1913 to 1990, the average growth rate of per capita gross domestic product was only 0.6% per year.

Things changed in 1991, when Domingo Cavallo took over as Economy Minister. His reforms were pro-market and featured fixing the peso at 1-to-1 parity with the U.S. dollar. He also pushed trade liberalization and reforms of public finance and the banking system. Despite the recession of 1995, induced by the Mexican peso crisis, Argentine per capita GDP grew at an average rate of 4.8% during the Cavallo years, through 1996.

But Argentina recently took a turn for the worse. Per capita output has fallen by 3.2% per year since 1998. In March, 2001, President Fernando de la Rúa's new Economy Minister, Ricardo López Murphy, failed when a reasonable program of curtailing public spending hit a political roadblock. Now there is talk in the markets of default on Argentina's foreign debt.

Out of desperation, the President has turned to his political rival, Cavallo, to save the economy a second time. The initial reaction by many observers, including me, was positive. However, 2001 is not 1991, and Cavallo's proposals focus on confidence management without the brilliance and market orientation of 10 years ago.

PAY IN CASH. Cavallo's program can be understood as a reaction to two concerns, the size of the fiscal deficit and the overvaluation of the currency. Wary of the fate of López Murphy, Cavallo proposes to end the deficit not by trimming public outlays but by raising taxes. The main new revenue device is a levy on financial transactions through the banking system.

There are several problems with this approach. One is that the economy would actually benefit more from lower spending than from higher taxes. In fact, Argentina needs to boost its low level of investment by cutting the high tax rates on business income. Another problem is that the new tax will highly distort the financial system, pushing Argentines to use offshore banks and pay in cash.

Cavallo also seeks to ease worries about default on public debt by persuading corporations and banks to hold more government bonds. The payoff to the banks—if the central bank can be induced to ease its tough policy on reserve requirements—is that these bonds would count,

in part, as reserves. Unfortunately, this could make banks riskier enterprises.

The appreciation of the peso—caused by the dollar link and the strength of the dollar—made Argentinean goods and labor too expensive. The market reaction is for Argentina's prices and wages to fall, but this deflation takes time, and unemployment rises in the meantime. The challenge is to avoid the contraction without jeopardizing currency convertibility, the main pillar of the 1990s revival.

ODD TIMING. Cavallo's proposals tinker with convertibility without abandoning it. He tries to devalue without officially devaluing by erecting a sharp rise in import duties on consumer goods. The adverse consequences of this protectionism are well known, and the announcement that the tariffs are temporary is reassuring.

Cavallo wants to replace the peso's link with the U.S. dollar with a tie to a 50-50 dollar-euro basket, but only after the euro appreciates to parity with the dollar. The inclusion of the euro is understandable because Argentina's trade with the euro zone has been comparable to its trade with the U.S. However, the timing is odd. President Bush just proposed in Quebec, Canada, a Free Trade Area of the Americas. The idea of waiting for dollar-euro parity to be confusing. If Cavallo knows that the euro will appreciate, then he could solve Argentina's problems by speculating in the euro.

Cavallo's plan is especially puzzling because of the fiscal deficit (2% to 3% of GDP) and devaluation are not much different from previous years, when the economy was growing. The crucial element is one of confidence, but financial markets would be reassured more by a coherent program of reform of state spending, rather than a short-term revenue fix by hiking taxes. Conversion also requires maintenance of dollar convertibility, but announcements of new kinds of pegs combined with pressures on the central bank to ease, undermine this confidence. That is, if interest rates in Argentina are so high.

I would have preferred a bolder plan for dollarization of the Argentine economy, or negotiations with the U.S. to extend trade status to Argentina. This deal could include compensation for conversion to the dollar.

Everyone needs heroes, and Cavallo was not mine. Maybe the Cavallo of 2001 was around and help to turn around Argentina's economy. Maybe.

Robert J. Barro is a professor of economics at Harvard University and a senior fellow of the Hoover Institution (rjbweek@harvard.edu).

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BY GENE KORETZ

THE U.S. SPREADS THE PAIN

Slowing imports will hurt overseas

At first glance, the latest U.S. trade numbers appear to be good news, especially for those who worry about America's huge and chronic trade deficit. The monthly trade gap shrank sharply in February by 19%, as imports tumbled 4.4% after slipping for several months, and exports rose by 1%.

Significantly, the import drop was broad based, encompassing both consumer and capital goods, especially high-tech items. The surprisingly sharp

WHO'S AT RISK FROM SLOWING U.S. IMPORTS



improvement in the trade numbers is expected to add at least a percentage point to the first quarter's growth rate. "The import declines imply that some of the drag from inventory reductions in the U.S. was diverted overseas," says Maury Harris of UBS Warburg.

The problem is that the world economy seems in no shape to absorb a pronounced slowdown in U.S. demand. As economist Joseph Quinlan of Morgan Stanley notes, during the recessionary early 1990s, developing nations acted as a global buffer to weakening demand in advanced nations. As their growth accelerated, their trade deficit with the industrialized nations soared from \$6.1 billion in 1990 to more than \$100 billion in 1993 and \$138 billion in 1995.

But this time around, developing nations are in no position to act as a buffer to economic weakness elsewhere. Indeed, until recently, the mammoth U.S. economy assumed that role—pulling crisis-stricken Asia and others out of recession by sucking in enough imports to help developing nations transform

their trade deficit into an estimated \$170 billion surplus by last year.

Thus, any improvement in the U.S. trade balance caused by slowing import demand needs to be weighed in light of its impact on sluggish economies overseas. And with the U.S. teetering on the edge of recession, Japan still mired in weakness, and growth in Europe slowing, that impact could be considerable.

The nations most at risk are those whose exports to the U.S. weigh heavily in their domestic economies. These include not only Canada and Mexico, but many nations in East Asia that are already grappling with falling industrial output and weak domestic demand.

An analysis by UBS Warburg economists indicates that U.S. import growth in recent years has been largely driven by America's investment and consumption binge on high-tech goods. That implies that the current information-technology slump spells especially bad news for such large IT exporters as Singapore, Taiwan, South Korea, the Philippines, and Malaysia.

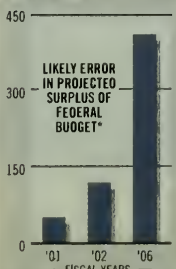
NO BUDGET SURPLUS IN 2011?

Projections can be off by a lot

While Congress wrangles over how much of the coming decade's projected budget surplus to convert into tax cuts, the surplus itself is looking a bit peaked. The usual March deficit actually was \$15 billion, or 25%, larger this year than last—the second straight month in which the year-to-year budget numbers deteriorated.

The latest numbers underscore how uncertain budget projections are. Indeed, based on its average errors in past projections, the Congressional

MARGINS OF ERROR



Budget Office calculates that its recent projection of a \$313 billion surplus next year and a \$505 billion surplus in fiscal 2006 could be off by \$120 billion and \$412 billion, respectively.

The CBO reports that a mild recession this year would only reduce its cumulative ten-year

projected surplus of \$5.61 trillion in fiscal 2011 to \$5.48 trillion if its assumptions prove accurate. But a big if. After analyzing the CBO's record, economists at the Federal Reserve Bank of St. Louis recently concluded that such cumulative projections are hardly reliable. "The government they write, 'is as likely to experience a deficit as it is to experience a sur-

SHE'S A WOMAN OFFER HER LESS

A game sheds light on the pay

In the rarefied world of economic theory, wages are ultimately determined by the workers' productivity. In the world, of course, discrepancies are common—a notable one being the gap between men's and women's pay.

In an intriguing study in *Economic Inquiry*, Sara J. Solnick of the University of Vermont describes an experiment that may throw light on the reasons for this gender gap's persistence. The experiment involves the so-called ultimatum game, in which one player is given some cash, say \$10, which he then offers to share with another. The size of the one-time offer is decided by the first player. If the second player accepts, the money is divided. If she balks at the size of the offer or refuses, neither gets a dime.

Past studies using the game in the lab that offers tend to be close to \$3, perhaps because players are motivated by considerations of fairness. So the twist was to add the element of gender. Using a mixed group of male and female students, she designed the experiment so that neither the offer maker nor those receiving offers could see the other player. In the games, however, each player was told the other player's first name, which was obviously male or female.

The results were revealing. When the players' sex was known, male players made lower offers to women. And on the receiving end, both men and women insisted on a larger amount when they knew the offer was from a woman.

Applied to salary negotiation in the real world, the implications are clear. The results suggest that despite significant increases in women's real wages in recent decades, both sexes still feel that women will accept less pay than men and that women are more malleable in a bargaining situation.

MES C. COOPER & KATHLEEN MADIGAN

SHRINKING TRADE GAP LOOKS GOOD STATESIDE

a plunge in exports to America is hurting the rest of the world

U.S. ECONOMY

There were two big surprises on Apr. 18. One was the Fed's rate cut at about 11 a.m. The other, just hours earlier, was the Commerce Dept.'s announcement of a dramatic narrowing in the February trade gap, which got lost amid the hoopla over the Fed. It shouldn't have. The February trade gap for goods and services was a stunner. It shrank from \$33.3 billion in January to \$27 billion, far below expectations. The result means that the steady widening in the trade gap in recent years is slowing, if only until the economy picks up again. As a result, the burden of fixing the ever-increasing U.S. external debt will at last stop growing, although the IOUs are still enormous. No mistake: The reason for the sudden shrinkage is a 4.4% decline in imports—the largest month-on-month drop on record (chart). While that plunge evinces a softening of U.S. demand, it also points up a key feature of the current business cycle: the stabilizing influence of imports, which now account for an increasing share of U.S. demand.

IMPORTS PLUNGE AS DEMAND WEAKENS



The burden of dealing with excess inventories, since the surplus of goods in U.S. warehouses are imports. Filled with the dollar still strong, inflation pressures remain minimal.

This is just the opposite of what happened a year ago. Back then, when demand was booming at an unsustainable rate, imports satisfied part of the demand. Aided by a strong dollar, foreign competition kept pressure off goods inflation, and the widening trade gap was a restraint on economic growth.

THE SOFTER GLOBAL CONDITIONS, exports also rose for the second month in a row, to \$90.5 billion. The gain was led by a big increase in aircraft and autos. Excluding planes, exports declined, and are unlikely to help reduce the trade gap in coming

months. Softer foreign economic growth, already evident in Japan and elsewhere in Asia and now starting to be seen in Europe, will limit export gains.

Also, the 10% surge since early 2000 in the trade-weighted dollar, adjusted for prices across a broad array of countries, will hurt many U.S. exports by making them more expensive. The dollar is now at levels not seen since the superdollar days of the mid-1980s, although demand is always the more important factor.

That's why the broad nose-dive in February imports, to \$117.4 billion, was worthy of attention. It means that many foreign producers are helping U.S. companies shoulder the load of slower growth in consumer spending and business outlays for equipment. Put another way, the rest of the world is already feeling the impact of the U.S. slowdown.

Although the U.S. is some 28% of world GDP, its global impact is far greater in terms of tradable goods.

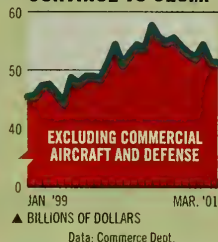
Imports will weaken further in coming months, especially since businesses are cutting back sharply. Durable goods orders in March rose 3%, but that reflected big gains in defense and aircraft. Orders for nondefense, nonaircraft capital goods dipped 0.7%, the fifth drop in six months—a sign of still-slipping business confidence (chart).

Moreover, consumer jitters worsened in April. After rising in March, the Conference Board's index of consumer confidence fell back in April, erasing all of the previous month's gain. Households seemed increasingly nervous about employment conditions. The recent jump in gasoline prices means May confidence may not look any better. Still, consumers' actions belie their worries. Sales of existing homes in March rose to a near record level, and new-home demand hit an all-time high.

CONSIDERING ONLY GOODS, and excluding oil, foreign-made merchandise now accounts for 28¢ of every dollar spent on such goods, up from only 19¢ a decade ago. That surge partly reflects imports of high-tech equipment and components associated with the investment boom. Adjusted for falling prices of tech equipment, that share would be even higher.

In fact, the most dramatic shift in the U.S. trade ac-

CAPITAL-GOODS ORDERS CONTINUE TO SLUMP



Business Outlook

counts in recent years has occurred in capital goods. In only four years, the trade balance for capital goods, adjusted for price changes, has swung from a surplus of \$27 billion to a deficit of \$80 billion, accounting for a big chunk of the widening in the overall trade gap. While U.S. companies have been busy exporting the New Economy overseas, they have been importing high-tech gear and components at an even faster clip. On the plus side, the increase in imported tech equipment is helping to boost productivity and keep inflation low.

Moreover, you can bet that some portion of top-heavy tech inventories came from abroad, so the required inventory adjustment will affect output at overseas companies, at least partly diminishing the impact on U.S. production. For example, as U.S. businesses continued to cut back on outlays for capital equipment in the first quarter, imports of capital goods dropped 4.8% in January and a further 4.5% in February. In particular, semiconductor imports, which fell 7.6% in January, dove 9.5% in February.

BUT WHILE IMPORTS offer the economy some short-term stability, they are fast becoming a long-term problem. That's because the ever-swelling market share of imports is embedded in the structure of the U.S. economy. And that dependency means a continued rise in the U.S.'s foreign financial obligations, which have already reached levels that appear unsustainable.

By the end of 2000, the U.S. current account deficit, the broadest accounting of those obligations, was more than four times larger than it was at the end of 1995 and it had grown to a record 4.6% of GDP. Economists at Credit Suisse First Boston estimate that the U.S. is already commanding more than 80% of the world's savings in the effort to finance that gap.

For now, at least, foreigners show no signs of bailing out of U.S. investments. Despite the bust in tech stocks and the U.S. slowdown, the dollar continues to soar (chart). The greenback's strength reflects the belief of overseas investors that, despite the erosion of U.S. profitability in the short term, the long-run profit potential of U.S. investments remains compelling, compared with those in other parts of the world.

Global confidence in the Federal Reserve, and that the Fed's aggressive rate-cutting will revitalize U.S. demand, are probably the most important supports under continued strong foreign investment in the U.S. The only problem: When U.S. demand picks up, so will imports. And that will require even more foreign financing.

THE DOLLAR SOARS TO NEW HEIGHTS



MEXICO

THE U.S. COUGHS—AND MEXICO MAY CATCH A COLD

Being the U.S.'s second-largest trading partner is both a blessing and a curse. Since the North American Free Trade Agreement began on Jan. 1, 1994, Mexico's exports have tripled, and 88% of them go to the U.S.

But now that the U.S. economy is slowing, Mexico is feeling the pain. Its real gross domestic product grew 6.9% in 2000, but the Central Bank expects growth of just 3% this year. Industrial output fell 3.7% in the year ended in February (chart), while analysts had expected a 1% rise. Manufacturers are cutting back output at dozens of Mexican plants, especially in the export-oriented northern states.

At the same time, Mexico's peso

is the world's second-best-performing currency, appreciating about 3% so far this year, to 9.28 per U.S. dollar. That's due in part to an influx of foreign cash lured by the 13.92% rate for Mexico's 28-day treasury bills.

Foreign investment in the money market at the end of March totaled \$2.25 billion, up 26% from December, 2000. The Central Bank has kept interest rates high to reduce inflation to 6.5% this year, with an eye toward reaching the target of U.S.-level inflation of 3% by 2003. But the strong peso has exporters howling that they're losing competitiveness just as U.S. companies are seeking to lower their production costs.

So far, there are no real danger signs in Mexican finances. The country has \$38.9 billion in international reserves. And the government is on track to have a fiscal deficit of less than 1% of GDP this year, thanks to still-high export prices.

But an economic slowdown will impact tax revenues, possibly making it difficult for Mexico to meet its budget goal of a deficit of 0.65% of GDP. Mexico collects 11% of GDP in taxes, and a tax reform bill now before Congress may not pass before October. Some legislators object to a 1% value-added tax on food and medicine. They argue the tax would hurt Mexico's 40 million poor. President Vicente Fox says it's the most efficient way to raise needed revenue.

By Geri Smith in Mexico

INDUSTRIAL ACTIVITY DROPS OFF SHARPLY



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a sentence with
"If only I could..."

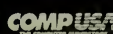


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THE STATES GET SQUEEZED

Post-boom, they can't count on the same kind of cash flow

As Washington lawmakers struggle to shape the federal budget amid the economic slump, they can take some solace: They're hardly alone. In state capital after state capital, elected officials are huddled over their spreadsheets, watching the gains of the New Economy boom—and their own revenues—disappear.

For much of the 1990s, states were awash in surpluses. They cut taxes and lavished spending on education and other popular programs. All the while, governors and state legislators basked in the glory of growing surpluses and strong bond ratings.

Not anymore. Soggy corporate profits, a lousy stock market, nervous consumers, and recently enacted tax cuts are eating away at state budgets. At the same time, soaring health-care costs and an insatiable public demand for improved schools are quickly draining public coffers. The result: For the first time since the

early 1990s, governors and legislators face agonizing choices.

A handful of states, including North and South Carolina, may have serious budget shortfalls this year. And although dozens of others will scrape through 2001 with few spending cuts, big problems may be ahead. Many legislatures are struggling to balance budgets for the coming fiscal year, due to begin in most states on July 1. Already, two dozen states expect revenue growth to slow in the next fiscal year. "Throughout the expansion, everything fell into place

beautifully for states," says Steve Murphy, managing director for finance at Standard & Poor's Corp. of a sudden, revenues are falling—states are getting hit."

Whether that will lead to spending cuts or just the budget fix now being considered remains to be seen. But after so many flush years, a freeze will feel painful. Ohio is debating a lock on spending. California legislators, too, are looking to scale back new initiatives. And while there is little talk yet—of tax hikes, a handful of s

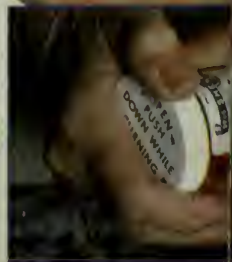


ENERGY

Oil- and gas-producing states, such as Alaska and Louisiana, have been pocketing a windfall. But stabilizing crude prices could mean falling revenues.

HEALTH CARE

Double-digit hikes in drug spending and overall medical costs are socking it to budgets across the country; Texas and Ohio have been hard hit.



Oregon, may delay one-time re-scheduled for the coming year.

good news is that states headed s slowdown with a solid financial. Thirty states, from Massachusetts to Arizona, began the year with es of at least 5%. Nationwide, were in the black by \$29 billion. in a prolonged slump, those re-will dwindle fast. Revenues will and new demands for health care to low-income families will cause g to explode. In the aftermath of dest 1991 slump, states quickly own their reserve funds by more 0% and raised taxes by 17%. day funds are not going to cut it, a mild recession," says Elizabeth s, senior policy analyst at the A. Rockefeller Institute of Gov- t in Albany, N.Y.

ady, the slowdown is taking its the fourth quarter of 2000, state es grew by just 4% overall, the

smallest increase since 1993, reports the Rockefeller Institute. But in some state-houses, things are far worse. In Iowa, budget analysts figured revenues would grow by a solid 3.4% this year; though in March, they were running a minuscule 0.3% higher than a year ago. In Kentucky, the budget was on track until six months ago. Now, thanks to plunging sales taxes, it faces a \$91 million shortfall. Says James D. Ramsey, executive director of the Kentucky Transportation Cabinet's Office of Technology: "The light switch was turned off."

HIGH PRICE. Other states are paying the price for tax cuts legislated during better days. In 2000 alone, 17 states reduced taxes by \$9 billion. Much of that came from cuts enacted two or three years ago but not scheduled to kick in until last year. North Carolina, for instance, cut taxes by \$1.5 billion over the past four years. Now it faces a 2001 deficit that may hit \$1 billion. And Virginia's governor and legislature are battling over whether to slash spending by \$400 million to fund a cut in the personal property tax on cars. The levy was supposed to be gradually repealed between 1998 and 2003.

WELFARE

The slowdown could push many workers and their families back onto public assistance, particularly in hard-hit industrial states like Ohio and Wisconsin.



THE COFFERS

States whose revenues will be lower in 2002 than in 2001

States whose revenue growth will likely be lower in 2002 than in 2001

States whose revenue growth will likely be higher in 2002 than in 2001

States whose revenue growth will likely be the same

California officials are sweating over an expected drop in taxes on capital gains and options as they watch Silicon Valley highfliers crash. In fact, with 21% of the state's taxes generated by the stock market, analysts figure its \$79 billion in revenues will slump by as much as \$2 billion in the coming fiscal year. Already, the legislature is considering trimming a similar amount from Governor Gray Davis' ambitious \$82 billion budget. On the hit list: a new university campus and funds to buy new parks. And legislators think the tax shortfall will only worsen. "In the second half of next year, it's going to be a nosedive," says Senate Budget Committee Chairman Steve Peace. "We're going to have to really cut."

Massachusetts, too, was awash in surpluses. But tax collections for the year will be up barely 0.2%, according to the Massachusetts Taxpayers Foundation. While that has led to modest cutbacks, it's nothing like what the legislature is about to do to the coming year's budget. "There won't be enough money to give people the increases they've come to expect," says Michael J. Widmer, president of the foundation.

Holding down spending will be tough for states. That's because their biggest single program, elementary and secondary education, has become untouchable in recent years. It accounts for nearly 21% of spending; in 2000 alone, outlays were up 6.8%, according to the National Association of State Budget Officers.

Medicaid, the health-care program for the poor, enjoys no such political protection. Regardless, a slowing economy will likely force increased spending. It already accounts for 19.6% of all state outlays. And at least 23 states that did



EDUCATION

States with booming populations, such as Florida and Colorado, have little choice but to keep boosting spending on K-12 programs.

not budget enough for the program are being forced to pump millions of extra dollars into Medicaid as the costs of prescription drugs and other benefits rise at nearly double-digit rates. "States are getting clobbered for the same reason everybody else is," says James Fossett, a Medicaid analyst at the Rockefeller Institute. "Put that together with a slowdown in state revenues, and budget guys are saying, 'gulp.'"

To save money, at least a dozen states have tried to scale back what they pay pharmacies for Medicaid prescriptions. But the effort has generated a firestorm of resistance. In Illinois,

drugstore giant Walgreens Co. responded by threatening to reduce business hours in stores in the poor neighborhoods where many Medicaid recipients live. "Virtually all these stores are losing money," says CEO L. Daniel Jorndt. The company is now trying to get the state to raise reimbursements.

Most troubling of all, these costs are swelling while employment remains relatively strong. Rising jobless rates would increase pressure on states to provide assistance to many poor working mothers and their children. States will have to reckon with the consequences of welfare reform, which

sharply limits what Washington will pay for such aid.

As they finalize budgets for the coming year, many legislatures still think they can keep their ledgers in the black with only modest spending cuts. But for the first time in nearly a decade, there is a palpable sense of gloom in state capitols. The worst, most legislators and analysts believe, is yet to come.

By Howard Gleckman in Washington, with Ann Therese Palmer in Chicago, Christopher Palmeri in Los Angeles, Ushma Patel in Atlanta, Stephen Anderson Forest in Dallas, and George Smith in Boston

GOVERNMENT

STATE LOTTERIES ARE COMING UP SNAKE EYES

Revenues are down just when they're most needed

The cooling economy couldn't have come at a worse time for Ohio.

With tax revenues this fiscal year likely to hit just \$15.7 billion—\$304 million less than expected—the state is struggling to fund new education programs that could cost \$700 million annually. Why not turn to revenues from the state lottery, which are earmarked specially for education? If only Ohio could. Over the past three years, lottery proceeds have tumbled 8%, to \$686 million. "I think [the lottery] is faltering," says state House Speaker Larry Householder.

Across the country, the story is much the same. Just a few years back, state after state bet that permitting a tepid form of legalized gambling would keep money rolling into state coffers. But despite their easy-money aura, lotteries haven't made the states rich. Lottery revenues are drying up as players grow more scarce and rival forms of gambling prosper. "The booming economy is not masking the long-term decline in lotteries anymore," notes John W. Kindt, a commerce professor at the University of Illinois in Champaign.

Indeed, the number of states that are seeing a slide in lottery profits keeps growing. In the last fiscal year, profits from 20 of the nation's 37 state lotteries fell. That's up from just eight states five years ago. Last fiscal year, annual lot-

tery profits in Wisconsin, for instance, dropped 19%, to \$110 million; in Texas they fell 8%, to \$890 million, while Connecticut profits dipped 6%, to \$254 million.

No one could have predicted this roll of the dice as states rushed to open lotteries in the 1980s and '90s. Legisla-



LOSING NUMBERS: Lotteries have too much competition

tures promised the lottery would be a growing source of revenue—and in many cases, the money was pledged to support popular programs. Today, 14 states direct all lottery proceeds toward education, while five more target a portion. In Texas and Ohio, for example, lotteries foot 8% to 10% of each state's education bill, respectively.

So why the decline in lottery proceeds? Just like any other industry, lotteries today face much greater competition. Eleven states now have general

casino or riverboat gambling, while 15 Indian tribes have built casinos in 10 states since 1988. All are luring gamblers who once played the lotteries. And that's not even counting the proliferation of lotteries have lost to online gambling, not to mention online stock trading.

SEDUCTION. But new rivals are only part of the problem. Many lotteries have done a poor job of attracting younger people, so the pool of players is shrinking. To seduce more youthful gamblers, states have tried new games. Illinois, Kansas, and Maine, for example, have launched scratch games featuring professional wrestlers. But so far, it hasn't been enough. And regarding

age, most players eventually get tired of losing and quit. Consequently, it takes ever-increasing jackpots—such as the \$100 million Powerball—to attract players, but these games are hard to win. "It's a self-destructive cycle," says Kip Peterson, a consultant at Transnational Development Inc.

Moreover, bigger prizes don't always translate into shrinking ticket sales. Last year, for example, New York increased its prize payout per dollar of ticket to 65¢, from 55¢. So far, though sales hit a record \$1.43 billion in profits were less than what the state brought in four years earlier.

Nor do the states have many easy-money options. Interstate gambling laws prohibit states from selling lottery tickets over the Internet. And opposition to gambling has kept all but a few states from installing popular video lottery terminals. "The lottery is not a people made it out to be and never will be," says Texas legislator Paul Pennington. For most, counting on lottery revenue looks increasingly like a sucker bet.

By Robert Berner in Chicago

COMMENTARY

By Paul Magnusson

THE REAL TRADE WARS WILL BE AT HOME

resident George W. Bush may have raised eyebrows when he drank straight from a water bottle at a diplomatic dinner at the United Nations in Quebec.

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l payoffs for Bush and the

isphere's economy. The White

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of the Americas could boost

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struggling democracies and,

important, provide the nation's

ntrodden farm and manufactur-

sectors with a vast new export

ket. Establishing the Free Trade

of the Americas (FTAA) would

eclipse President Clinton's

ovement of knitting the U.S.,

ico, and Canada together in the

h American Free Trade Agree-

t of 1994.

WICKING. But Bush faces even

er political hurdles wresting a

deal out of Congress than did

on. Add to that resistance from

e Latin leaders and reluctance by

ected U.S. industries to face im-

competition. Even the first step

t be easy: getting authority from

gress to negotiate the FTAA on a

lative "fast track," which would

force Congress to approve or deny whatever deal Bush brings to them—without amendments. Fast track, which lapsed in 1994, is also crucial to Latin leaders. None wants to sign a trade pact with Bush only

the top Democrat on the House trade subcommittee: "They can't just send up something and shove it through." That's a reference to the strong-arm tactics the GOP leadership used in getting Bush's tax bill

through the House on a straight party-line vote. Since some anti-trade Republicans can be expected to vote against fast track, Bush may need votes from 20 or more Democrats in the closely divided House.

Even if Bush gets the congressional go-ahead, he's still not home free. Powerful U.S. industries will fight to keep high tariffs, quotas, and subsidies. Brazil, for example, wants access to the U.S. markets for its citrus, sugar, and vegetables; it also wants the U.S. to cut its crop subsi-

dies. That doesn't wash with GOP Senator Charles Grassley, the Iowa farmer who chairs the Finance Committee. Standing by a barricade while dabbing tear gas from his eyes with a handkerchief in Quebec, Grassley said: "That's not going to happen within the FTAA; we are not going to

WHY BUSH AND BUSINESS WANT A FREE-TRADE ZONE

► To counter moves by Europe and Canada to cut free-trade deals with Latin American nations.

► To gain access to the Latin American market—particularly Brazil's \$650 billion economy. Only 8% of U.S. ex-

ports currently go south of Mexico.

► To reassert U.S. leadership in trade, which has lagged recently. No other country has stepped forward to lead the process.

► They claim it will build a model for globalization that fosters education and democracy, and helps to protect the environment.

FAST-TRACKER

To sign hesitant nations, Bush needs the ability to push a deal through Congress

to have to renegotiate it with a nipping Congress.

But the White House as yet has no plan for getting fast track, other than to change the yet-to-be-drafted bill's name to "trade promotion authority." Democrats insist that the legislation must commit the President to negotiate protections for the environment and workers' rights directly into the FTAA. Although most business groups are in favor, as long as trade sanctions aren't used as enforcement tools, the Administration has been hesitant.

That's because there is outright resistance on the GOP right. House Majority Leader Richard K. Armey (R-Tex.), insists that "trade is too important to be compromised by the ideology" of labor leaders and environmentalists. But if Armey gets his way, Dems will balk. Says Representative Sander M. Levin (D-Mich.),

NO COMPROMISES Dick Armey wants the FTAA to be free of labor or environment clauses

unilaterally disarm."

Bush could overcome such reluctance in Congress by selling voters on the benefits of globalization. Ultimately, the true test of his skills as a world leader may yet depend on his ability to persuade the American public.

Magnusson covers international trade from Washington.



CORPORATE EARNINGS

THE PROFIT PICTURE IS GETTING UGLY

And, so far, the next quarter isn't looking much better

How the mighty have fallen—and the not-so-mighty, too. Across the corporate landscape, earnings are plummeting, brought down by the slowing U.S. economy, the stubbornly strong dollar, and high energy costs. *BusinessWeek's* flash-profit survey of 122 bellwether companies shows that first-quarter net income sank 19%, despite a sales increase of 14%. And even that dismal performance includes a lift from highfliers in the energy sector such as Exxon Mobil Corp. Without those anomalous gains, year-over-year results fell 25%. "It's good to have this one behind us," sighs John V. Faraci, chief financial officer at International Paper Co., after reporting a 93% plunge in first-quarter earnings, to \$18 million.

The worst isn't over, however. The second quarter is likely to be just as humbling, and analysts widely predict third-quarter profits will be down, too. Economists at Standard & Poor's Corp. estimate that the net income of the 500 companies in its benchmark index tumbled 18% in the first quarter. That's on top of a 5% slide in last year's final period. Worse, they forecast another 10% drop in the second quarter—marking the first double-digit earnings decline in two consecutive quarters since 1992, when business was still recovering from a recession.

DOWNDRAFT. Indeed, the earnings slump is so severe that Federal Reserve Chairman Alan Greenspan is now focusing far more attention on earnings than he has in the past. In explaining its last two interest rate cuts, the Fed singled out shrinking profit margins as a reason to worry.

Why are things likely to get worse before they get better? Already shaken by the stock market's plunge, Americans are growing anxious about jobs. That means con-

sumer spending is expected to drop, especially on durable goods as well as snazzy electronic gadgets. Sears, Roebuck Co. is caught in the downdraft. Its net income skidded 25% in the first quarter, to \$176 million, and the retailer has warned of another double-digit decline in the second quarter.

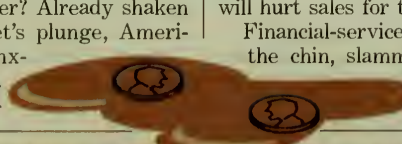
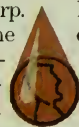
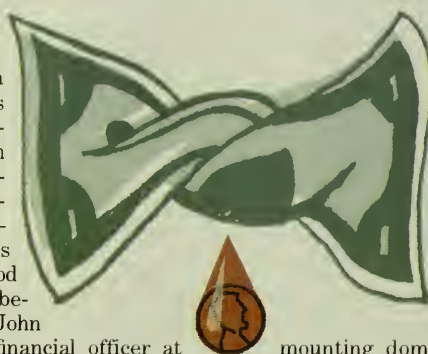
Corporations, meanwhile, are also snapping their wallets shut as they prop up the bottom line by curtailing capital spending and discretionary outlays. And executives detect that the U.S. malaise is spilling into Europe and Asia—regions that had until now acted as counterweights to mounting domestic woes. "It is a global slowdown," declares Richard Berner, chief U.S. economist for Morgan Stanley Dean Witter & Co. "It is U.S.-centric, but it is global."

There were, of course, a few standouts in the first quarter. Riding high along with the rest of the energy sector, Exxon Mobil netted \$5 billion in the quarter, thanks to rising oil and gas prices. Boeing Co. and IBM also posted higher results, albeit thanks to easy comparisons with the 2000 quarter.

But there were many more losers. Airlines were among the worst off in the quarter. All but two of the major carriers—Continental and Southwest—posted losses, with UAL reporting a jaw-dropping deficit of \$304 million as business travelers stayed put or booked cheaper coach-class tickets. Earnings of commodity makers also slid. Net income at DuPont swooned 40%, to \$484 million.

The car industry hit the brakes, too, with earnings at industry leader General Motors Corp. nose-diving 87%, to \$225 million. Auto makers remain fearful that dropping consumer confidence will hurt sales for the rest of 2001.

Financial-service firms also took it on the chin, slammed by Wall Street's woes. Earnings at J.P. Morgan Chase,



CURRENT
(MIL)

INDUSTRIALS

427.2

ABBOTT LABORATORIES	3.5
AIR PRODUCTS & CHEMICALS †	1.4
ALCOA	6.1
AMERICAN HOME PRODUCTS	3.4
AMERICAN STANDARD	1.7
ARCHER DANIELS MIDLAND ††	5.1
BOEING	13.2
BRISTOL-MYERS SQUIBB	4.8
CATERPILLAR	4.8
CHEVRON	12.2

COCA-COLA	4.4
COLGATE-PALMOLIVE	2.2
CONAGRA FOODS ††	6.4
CONOCO	10.2
CROWN CORK & SEAL	1.6

DELPHI AUTOMOTIVE SYSTEMS	6.5
DUPONT	6.8
EASTMAN KODAK	2.8
EXXON MOBIL	57.2
FORD MOTOR	42.3

GENERAL ELECTRIC	30.4
GENERAL MILLS ††	1.7
GENERAL MOTORS	42.0
GEORGIA-PACIFIC GROUP	6.1
GILLETTE	1.1

GOODYEAR TIRE & RUBBER	3.4
HONEYWELL INTERNATIONAL	5.1
ILLINOIS TOOL WORKS	2.1
INTERNATIONAL PAPER	6.1
JOHNSON & JOHNSON	7.1

KIMBERLY-CLARK	3.1
LILLY (ELI)	2.1
LOCKHEED MARTIN	5.1
MAYTAG	1.1
MERCK	11.1

MINNESOTA MINING & MFG.	4.1
NIKE ††	2.1
NUCOR	1.1
OCCIDENTAL PETROLEUM	4.1
PEPSICO	4.1

PFIZER	7.1
PHILIP MORRIS	17.1
PPG INDUSTRIES	2.1
QUAKER OATS	1.1
RAYTHEON	3.1

SCHERING-PLOUGH	2.1
SCHLUMBERGER	2.1
TEMPLE-INLAND	1.1
TYCO INTERNATIONAL †	8.1
UNITED TECHNOLOGIES	6.1

USX-MARATHON GROUP	8.1
USX-U.S. STEEL GROUP	1.1
VALERO ENERGY	3.1
VISTEON	4.1
WEYERHAEUSER	3.1

WHIRLPOOL	2.1
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SERVICES

206

ALLSTATE	7.1
AMERICAN EXPRESS	5.1
AMR	4.1
BANK OF AMERICA	4.1
BANK ONE	4.1
BURLINGTON NORTHERN SANTA FE	2.1
CAPITAL ONE FINANCIAL	1.1

CHG.	EST. EPS (2/15)	REPORTED EPS	DIFF.		CURRENT QTR. SALES (MILLIONS)	% CHG.	QTR. PROFITS (MILLIONS)	% CHG.	EST. EPS (2/15)	REPORTED EPS	DIFF.
+4	0.54	0.57	+0.03	CITIGROUP	29,804.0	+11	3,580.0	-7	0.71	0.70	-0.01
86	0.49	0.47*	-0.02	CNF	1,278.5	-3	15.6	-59	0.57	0.26	-0.31
99	0.60	0.43	-0.17	CSX	2,025.0	0	20.0	-20	0.18	0.10	-0.08
15	0.46	0.46	—	DISNEY (WALT) †	6,049.0	-4	-567.0	NM	0.20	0.19*	-0.01
56	0.55	0.55	—	DOW JONES	459.9	-17	6.2	-93	0.57	0.17	-0.40
+8	0.90	0.90	—	DYNEGY	14,167.5	+165	137.5	+99	0.32	0.41	+0.09
10	0.22	0.15	-0.07	ENRON	50,129.0	+281	406.0	+20	0.44	0.47	+0.03
96	0.81	0.89*	+0.08	FEDEX ††	4,838.8	+7	108.7	-4	0.39	0.37	-0.02
10	0.65	0.63	-0.02	FIRST UNION	NA	NA	584.0	-30	0.62	0.59	-0.03
37	0.52	0.47	-0.05	FLEETBOSTON FINANCIAL	NA	NA	142.0	-87	0.86	0.79*	-0.07
33	1.88	2.49	+0.61	HCA- THE HEALTHCARE CO.	4,501.0	+5	326.0	+10	0.59	0.59	—
IM	0.34	0.35	+0.01	J.P. MORGAN CHASE	NA	NA	1,224.0	-38	0.74	0.58	-0.16
12	0.43	0.44	+0.01	MARRIOTT INTERNATIONAL	2,441.0	+13	121.0	+29	0.46	0.47	+0.01
31	0.21	0.19	-0.02	MBNA	NA	NA	311.1	+33	0.35	0.35	—
64	0.91	1.03	+0.12	McDONALD'S	3,511.7	+5	378.3	-16	0.34	0.29	-0.05
IM	0.08	-0.40	-0.48	McGRAW-HILL	846.4	+8	20.4	-53	0.12	0.10	-0.02
M	0.18	-0.04*	-0.22	MERRILL LYNCH	11,950.0	+6	874.0	-21	1.07	0.92	-0.15
10	0.54	0.46	-0.08	MORGAN STANLEY DEAN WITTER	12,777.0	+10	1,075.0	-30	1.06	0.94	-0.12
18	0.52	0.52	—	NEW YORK TIMES	778.2	-5	60.1	-25	0.46	0.36	-0.10
14	1.10	1.43	+0.33	OFFICE DEPOT	3,017.9	-2	56.3	-48	0.24	0.19	-0.05
15	0.52	0.56	+0.04	SAFeway	7,666.1	+8	283.9	+17	0.55	0.55	—
16	0.30	0.30	—	SCHWAB (CHARLES)	1,200.0	-30	97.0	-68	0.16	0.07	-0.09
-3	0.53	0.54	+0.01	SEARS, ROEBUCK	8,857.0	-1	176.0	-25	0.62	0.53	-0.09
17	0.26	0.50	+0.24	SOUTHWEST AIRLINES	1,428.6	+15	121.0	+27	0.17	0.15	-0.02
M	-0.15	-0.37*	-0.22	TENET HEALTHCARE ††	3,036.0	+7	198.0	+421	0.58	0.60	+0.02
10	0.19	0.17	-0.02	UAL	4,424.0	-3	-304.0	NM	-2.43	-5.82	-3.39
M	-0.05	-0.02*	+0.03	UNITED AUTO GROUP	1,395.0	+26	6.6	+16	0.17	0.21	+0.04
12	0.65	0.51*	-0.14	UNITED PARCEL SERVICE	7,510.0	+4	556.0	-32	0.58	0.48	-0.10
17	0.67	0.60	-0.07	WELLS FARGO	NA	NA	1,165.0	+12	0.67	0.67	—
13	0.21	0.04	-0.17	YELLOW	832.0	-6	1.7	-83	0.43	0.22*	-0.21
14	1.04	1.06	+0.02	TECHNOLOGY	81,172.3	+3	4,376.9	-56	0.25	0.17	-0.08
-8	0.86	0.81	-0.05	ADVANCED MICRO DEVICES	1,188.7	+9	124.8	-34	0.38	0.37	-0.01
28	0.73	0.74	+0.01	APPLE COMPUTER †	1,431.0	-26	43.0	-82	0.02	0.12	+0.10
14	0.21	0.25	+0.04	COMPAQ COMPUTER	9,197.0	-3	78.0	-76	0.20	0.05	-0.15
0	0.46	0.43*	-0.03	EMC	2,344.8	+29	398.8	+20	0.22	0.18	-0.04
11	0.72	0.71	-0.01	GATEWAY	2,033.5	-15	-479.1	NM	0.18	-1.48	-1.66
-7	1.18	1.13	-0.05	IBM	21,044.0	+9	1,750.0	+15	0.99	0.98	-0.01
13	0.54	0.35	-0.19	INTEL	6,677.0	-16	485.0	-82	0.21	0.07	-0.14
0	0.49	0.42	-0.07	JDS UNIPHASE ††	920.1	+133	-1,293.1	NM	0.17	0.14*	-0.03
4	0.92	1.37	+0.45	LEXMARK INTERNATIONAL	999.4	+12	79.7	-1	0.58	0.60	+0.02
8	0.32	0.34	+0.02	MICRON TECHNOLOGY †	1,065.7	-8	-4.1	NM	0.14	-0.01	-0.15
M	0.31	0.30	-0.01	MICROSOFT ††	6,456.0	+14	2,451.0	+3	0.43	0.44	+0.01
4	0.95	0.94	-0.01	MOTOROLA	7,752.0	-12	-533.0	NM	0.12	-0.09*	-0.21
0	0.67	0.75*	+0.08	ORACLE ††	2,674.4	+9	582.7	-24	0.12	0.10	-0.02
M	0.79	0.78	-0.01	SANMINA †	1,191.1	+26	62.2	+6	0.35	0.19	-0.16
11	0.31	0.28	-0.03	SOLETRON †	5,418.5	+85	121.9	+26	0.29	0.18	-0.11
0	0.48	0.38	-0.10	SUN MICROSYSTEMS ††	4,095.0	+2	136.0	-73	0.16	0.04	-0.12
3	0.43	0.41	-0.02	TEXAS INSTRUMENTS	2,528.0	-8	230.0	-49	0.21	0.13	-0.08
8	0.57	0.24	-0.33	XEROX	4,156.0	-8	143.0	NM	-0.26	-0.12*	+0.14
4	0.61	0.65	+0.04	UTILITIES & TELECOM	97,415.6	+31	3,995.7	-46	0.39	0.37	-0.02
7	0.85	0.86	+0.01	AT&T	16,763.0	+5	-1,562.0	NM	0.06	0.06*	—
3	0.96	1.55*	+0.59	BELLSOUTH	5,919.0	-8	891.0	-11	0.55	0.47	-0.08
9	-0.99	-1.12*	-0.13	CONSOLIDATED EDISON	2,886.3	+24	182.5	-5	0.93	0.84	-0.09
3	1.24	2.13	+0.89	DOMINION RESOURCES	3,156.0	+53	162.0	-4	1.22	1.20*	-0.02
9	0.16	0.24	+0.08	DUKE ENERGY	16,491.0	+126	554.0	+41	0.58	0.73	+0.15
6	0.73	0.61*	-0.12	QWEST COMMUNICATIONS INTL.	5,051.0	+50	19.0	-95	0.13	0.01	-0.12
1	0.98	1.10*	+0.12	RELIANT ENERGY	13,284.3	+215	208.2	+56	0.57	0.72	+0.15
5	0.59	0.55	-0.04	SBC COMMUNICATIONS	11,190.0	-11	1,864.0	+2	0.59	0.54	-0.05
9	0.72	0.70	-0.02	SPRINT FON GROUP	4,358.0	-1	316.0	-29	0.38	0.36	-0.02
8	0.53	0.40	-0.13	SPRINT PCS GROUP	2,051.0	+68	-393.0	NM	-0.35	-0.40	-0.05
M	0.33	-0.28	-0.61	VERIZON COMMUNICATIONS	16,266.0	+12	1,754.0	+12	0.72	0.72*	—
7	1.14	1.15	+0.01								
1	0.60	0.58	-0.02								
2	0.52	0.36	-0.16								
5	0.66	0.66	—								

† Second-quarter results

†† Third-quarter results

NM = not meaningful

NA = not available

*EPS adjusted for special items

DATA: COMPUSTAT, PROVIDED BY STANDARD & POOR'S INSTITUTIONAL MARKET SERVICES
EARNINGS ESTIMATE DATA PROVIDED BY I/B/E/S, A DIVISION OF THOMSON FINANCIAL

for example, were off 38%, to \$1.2 billion, as fees on IPOs and mergers dried up. Citigroup's profits also declined, slipping 7%, to \$3.6 billion.

Few sectors fell harder than tech, though, where titans had stood so tall a year ago. Intel Corp. logged an 82% decline in net income, to \$485 million, its third consecutive quarter of lower profits. The chipmaker warned that its mar-

gins would shrink further in the second quarter. Compaq Computer's first-quarter profit was off 76% as PC sales stalled, while Motorola reported its first operating loss since 1985.

To keep profits from disappearing altogether, many companies are battling back—with an ax. Motorola, DuPont, Intel, and Cisco are among the biggest job choppers. 3M, too, plans to lop 5,000

positions this year. Bracing for hard times, the St. Paul (Minn.) conglomerate is also paring capital expenses, putting the arm on vendors. "There are no clear signs the picture is improving anytime soon," warns 3M CEO W. J. McNerney Jr. Even a smudged crystal ball can confirm that.

By Michael Arndt in Chicago bureau reports

THE ECONOMY

THE LIPOSUCTION CAN WAIT

Signs of the slowdown pop up in some unexpected places

Mickey Orloff knows an economic slowdown when he sees one. The Foster City (Calif.) Little League president says this season kicked off with eight of his 50 teams failing to come up with sponsors. Now, teams in this Silicon Valley community like the Cubs and the Indians are having to go through a flurry of fund-raisers to scrounge up money for gear and uniforms. "It's an extremely unusual situation," Orloff laments. "In the past, we've had double sponsors for some teams." Almost as troubling, some businesses that have committed to paying the \$275 sponsor's fee have yet to come through. "We've had to second-bill and we may have to third-bill," he says. "The checks are coming in slowly."

Poor kids. They're the latest, if hardly the most tragic victims of the economic slump that's wreaking havoc across the country. From the heart of the New Economy to the industrial centers of the Old, signs of the slowdown are on the rise everywhere.

SECOND HAND. Indeed, back in Cincinnati, Mary McGregor has a suggestion for those Silicon Valley sluggers: Forget about shiny new bats and balls. McGregor, who runs a trio of Play It Again Sports franchises there, says business is booming as bargain-hunters trade in their worn-out equipment for slightly weathered bats, clubs, and rackets. "People are looking for a way to economize," says McGregor, adding that her foot traffic is up 10%.

There are plenty of deals on used computer gear, too, thanks largely to



COME IN, PLEASE: The Park Hyatt woos guests with credits

the flood of stuff being sold on the cheap by dead and dying dot-coms. Charles England, a 24-year-old in Newport, R.I., recently snared a Cisco Systems Inc. router on eBay for \$300. Purchased new, it would cost about \$700. "You can program it to do anything," says England. "It does a lot of things that I don't use it for, but it's nice to have," he says.

Another telling sign of economic trou-

"More patients don't keep appointments," says a cosmetic surgeon. "Probably the stock market has gone down that day"

ble, according to some: Movie attendance is soaring, as it has in past downturns. Sure, going to the movies, at up to \$10 a pop, is no deal. But it's far cheaper than taking the significant other to the theater, or hauling the family to a pro ballgame. "2001 looks phenomenal," with attendance up 20% over last year, says Bruce J. Olson, president of Marcus Theatres Corp., a Milwaukee-based movie chain with 49 multiplex theaters. "I've been in the business for 27 years," he says. "Compared with other economic downturns, this is tracking on par."

For the affluent, there's clearly an

upside to downturn: less harried. Danube, Manhattan's hot Austrian eatery with dinner drinks for can cost \$ the wait for table used to measured weeks.

N says reservat Elcira Pe patrons "can on the Wed day they war dine and pro bly get in." Rooms in posh hotels sitting empty, too: the pricey Park att is offering \$100 meal credits to weekend visitors to Chicago and o cities. It's much the same in Silicon ley. Says Intel Corp. Chief Execu Craig R. Barrett: "It's easier to g cab at San Jose airport, and there's traffic on the road."

But even for the well-heeled, w ping out the plastic whatever the p is no longer an automatic reflex. W new Administration in town, no on cutting back on dinner parties in nation's capital. Instead, says one W ington-based caterer, they're cutt corners by serving up wine at, say, a bottle, rather than \$60. In Chic "we've had the lightest foot traffic years," frets Lake Forest (Ill.) inte decorator Carolyn Finn, who cater: an affluent North Shore crowd. A in Beverly Hills, Calif., plastic surg Dr. Peter B. Fodor has also seen future, and it isn't pretty. He watched with dismay as demand sl ens for liposuction, breast impla face-lifts, and tummy tucks. "More tients don't keep appointment laments the surgeon. "Probably stock market has gone down that d As Nasdaq goes, so go his impla And so goes the country.

By Joseph Weber in Chicago, u Ann Therese Palmer in Lake For Ill., and Mark Hyman in Baltimore



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WALL STREET

THE IPO MARKET: PIPSQUEAKS NEED NOT APPLY

Big companies and energy outfits make up most of the offerings

Could the initial public offering market finally be thawing out? After a long, harsh winter, signs of IPO life seem to be popping up like crocuses in spring. There's the pending \$5 billion Kraft Foods offering, a deal by Prudential Insurance to raise \$3.9 billion, and the announcement, on Apr. 19, of plans by Accenture, the former Andersen Consulting, to move ahead with a \$1 billion offering.

But don't be fooled. This season's bloom isn't anything like the good old days, when an IPO of anything.com could be counted on to rocket upward. Now the IPO market is dominated by old-line companies that, for the most part, have size, brand name recognition, and, most importantly, profits. "You see companies coming to market that should—not some of these unproven, untested, immature companies we've seen the past few years," says Kyle Huske, market analyst for IPO.com, a Web site that tracks the offering market.

So, what's behind the push for mega-IPOs? A lot of the momentum is coming from Wall Street itself. Investment bankers, no longer able to peddle startups, have far more time on their hands these days. Instead, they are aggressively pushing far larger deals as companies set plans for spin-offs. "Wall Street needs to feed and now they have these megabillion-dollar spin-offs," says Richard Peterson, chief market strategist at Thomson Financial Securities Data. "That's bolstering the IPO market right now, but that can only go so far."

Indeed, the surprise is that any company at all is willing to brave an IPO at the moment. The first quarter was the worst for IPOs since the end of 1990, with just 24 deals offered. Compare that with 121 in the

opening quarter of 2000. Last year a total of 384 offerings hit the market; bankers now expect as few as 50 by yearend. The bulk of money raised, moreover, will come from just a few giant names. Of the \$7.5 billion raised in the first quarter, nearly \$7 billion went into just three megadeals: Agere Systems, the Lucent Technologies spin-off; KPMG Consulting; and a Hong Kong oil outfit, CNOOC Ltd. "The only merchandise the



IN THE IPO HOPPER

DEAL	REASON	EXPECTED PROCEEDS
KRAFT FOODS	To help pay down parent Philip Morris' \$11 billion debt	\$5 billion
PRUDENTIAL INSURANCE	To raise capital for overseas expansion and to beef up investment product	\$3.9 billion
RELIANT RESOURCES	Wants to enter the Texas energy market, which deregulates in 2002	\$1.4 billion
ACCENTURE	The ex-Andersen Consulting needs stock for acquisitions and employee options	\$1 billion

Data: Thomson Financial Securities

Street's been able to bring to the table are proven companies with proven earnings and proven cash flow," says F. Baranko, director of equity trading at Strong Capital Management Inc.

Even for these companies, however, the need to raise capital or spin off units outweighs the risks of going public in this market. Take the Kraft deal slated for May or early June. Philip Morris Cos., Kraft's parent, plans to take 10% to 15% of the company to pay down a portion of the \$11 billion debt owed for funding Kraft's acquisition of Nabisco Holdings Corp. in December. The company is also betting that putting distance between food and tobacco will bring Kraft more investor interest. "[Kraft's] value is being depressed by tobacco taint," says Romitha S. Mallik, food analyst with Goldman, Sachs & Co. **A TOUGH SLOG.** But given the performance of some of the mega-IPOs this winter and spring, investors shouldn't be too excited. Lucent's spin-off of Agere, for instance, wasn't exactly a barnburner. Lucent, which badly needed funds to pay down debt, cut Agere's offering price from \$20 to \$6. The company, which went public in March, traded for \$6.60 now following a first-quarter loss of \$148 million.

Not surprisingly, three of this year's best IPOs are energy companies; the top performer so far is Williams Energy Partners. The petroleum distributor has risen more than 50%, to \$32.50 a share since February. "Energy is in this very sweet spot right now," says Jeffrey E. Heil, director of equity investments for Regents of the University of California. But for most sectors, the 2000 IPO year is looking abysmal. KPMG Consulting is down 10% from its February debut of this year's 27 IPOs only 11 are above the offer price.

If IPOs no longer provide a quick route to riches, at least these companies will be around in a year or two—and they're unlikely to be back with hat in hand. "The IPO investors want to have some degree of confidence that this is likely to be the last funding you need," says Michael Christenson, technology investment banker and chief at Salomon Smith Barney. Translation: Anything.com need not apply.

By Darnell Little
Chicago with Marcia Valeri in New York



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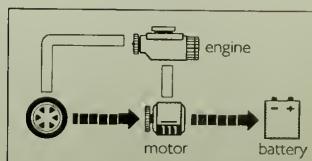
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COMMENTARY

By Peter Burrows

HP'S WOES ARE DEEPER THAN THE DOWNTURN

When Hewlett-Packard Co. Chief Executive Carleton S. Fiorina warned investors in January that revenues would grow only around 5% for the first half of 2001, she was among the first CEOs to cite an economic slump as the culprit. Since then, she has regularly trotted out that old tried-and-true CEO villain: If it weren't for the weak economy, we'd be doing much better.

But all is not well at HP. Many an-

facing big structural, cultural, and product problems. And fast-moving rivals like Dell, EMC, and Sun would be zooming even further ahead of HP. "This should have been an opportunity for HP to play catch-up," says Salomon's Jones.

Of course, a weak economy is nothing to be trifled with. Says HP spokesperson Suzette Stephens: "We've been ahead of the curve, unlike many of our competitors, who

figuration for one of its new servers. "It's painful to watch them screw up million-dollar deals." Indeed, the level of confusion among HP units appears at times to be spinning out of control. A company that sells Net-related hardware that works with HP gear reports going on a customer call at which 16 HP staffers showed up. "The customer asked who in the room was from HP—and then said only three could stay."

Beyond those structural problems, Fiorina's tenure has so far done little to improve HP's share in still fast-growing markets. The biggest problem is in corporate computing. Sales of its Unix servers grew just 6% last quarter, and its top-of-the-line Superdome server seems to be shaping up as a superbomb. Analysts say the server is technically fine, and, given HP's big customer base, should have been a sure thing. But with HP's sales and distribution efforts in flux, rivals including market leader Sun Microsystems Inc. and resurgent IBM are taking share from HP. As a result, they will be better positioned than HP to grow when the economy does turn around.

And what of Fiorina's promise to fire up HP's invention engines? Many of HP's top sellers—from its \$299 Photosmart 315 digital camera to its \$500,000-plus XP512 data storage product—are made by partners. HP adds some software, but its main contribution is its brand name and distribution networks. "They're trying very hard to innovate, but it's hard to find much success," says Lyra Research Inc. President Charles LeCompte.

After Fiorina blamed a drop in consumer spending in Europe for the Apr. 18 preannouncement, many analysts and rivals were baffled. "Both Compaq and Dell have grown at a pretty good rate," says Rob Walker, chief operating officer of the European division of Compaq Computer Corp., which saw PC sales grow 14% in the first quarter. "That's why we are a bit mystified by their statements." The question is whether Fiorina's mysterious remarks may be hiding a far more troubling reality.

With William Echikson in Brussels

TROUBLE BEGINS AT HOME

RESTRUCTURING

CEO Fiorina's sweeping moves were supposed to improve efficiency and sales efforts. So far they've mostly caused confusion.

POOR PRODUCT MIX

Even though HP promised strong growth of high-end servers and storage units, recent sales grew mostly in lower-end PCs and printers.

SLOW INNOVATION

Despite Fiorina's strategy of developing new products in-house, HP is relying more on its brand-name clout.



FIORINA: No promising news

analysts considered Fiorina's projections earlier in the year that HP would turn in 15% growth over the top. Since pulling back in January, Fiorina has lowered the bar again. On Apr. 18, citing a slowdown in consumer spending in Europe and elsewhere, she said sales would shrink 2% to 4% in the quarter ending Apr. 30. She also said HP would likely show no growth for the next two quarters. Says Salomon Smith Barney analyst John B. Jones: "Her credibility hasn't gotten any better."

Lost in the deluge of bad news that has hit virtually every company in the tech sector is one salient truth: HP should be doing much better than it is. Even if the economy was still humming, HP would still be

were taken by surprise." But HP's problems are more basic. A top concern at HP is Fiorina's sweeping year-old reorganization. In place of a 60-year-old decentralized approach, she split HP into three product development groups: for printers, computers, and digital appliances. She also split sales and marketing into three groups: for consumers, corporate markets, and consulting services.

CONFUSION REIGNS. In theory, the reorganization plan should help HP become an e-business powerhouse. In practice, it has caused mostly confusion and gridlock. "It's beyond my ability to communicate our frustration," says one computer reseller who has struggled for two months to get HP to work out a customized con-



ROBIN NOTICED THE PROBLEM ALMOST IMMEDIATELY

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COMMENTARY

By Catherine Arnst

RELAX, MOM. DAY CARE WON'T RUIN THE KIDS

Once again, the childcare debate has erupted into a firestorm. The spark: Press reports saying a huge study found that childcare makes kids aggressive and mean. Funny thing is, most of the researchers involved say the study uncovered no such thing.

In fact, the study shows that preschoolers who spend lots of time in childcare are no more aggressive than the preschool population at large. Those who do act up are only one level above the standard for good behavior—just what one expects to find in rambunctious 4- and 5-year-olds. What about kids cared for by stay-at-home moms? True, far fewer than the norm display aggressive behavior. But they quickly catch up once they enter school.

"MISLEADING." How could such benign data be so misrepresented? Because early press reports relied on the account of just one out of 29 researchers who worked on the study—Jay Belsky, a longtime childcare critic. His colleagues were not pleased. "We don't agree with him on his interpretation," says Sarah L. Friedman, scientific coordinator for the study. "The data he presented was accurate but only part of the story, so that can be very misleading."

The Early Child Care Study, sponsored by the National Institute of Child Health & Human Development (NICHD), has been following 1,300 children at 10 locales around the country since 1991. Interim results were presented on Apr. 19 at a meeting of the Society for Research in Child Development. But the news reports weren't based on the scholarly presentations. They came from a press conference organized by the society the day before, and manned by only Belsky and Friedman because the rest of the team hadn't arrived yet.

Belsky, a professor at the University of London, has been stirring



PRESCHOOL: Less aggression at home—but only till school starts

controversy ever since he published a hotly debated study in 1986 suggesting that infants who spent many hours in child care were at risk of later behavior problems. The conservative Scaife Family Foundation, whose stated mission is "to promote the well-being of the family and traditional values," has funded some of his research. "He is more extreme in his views than the rest of us," says fellow NICHD researcher Martha J. Cox of the University of North Carolina. That was evident at the press conference, when Friedman disavowed Belsky's assertion that parents worried about aggression should cut back on child care.

Friedman says there's no

proof of cause and effect. More important, there's no evidence a problem exists. Of the preschoolers observed who spent 30 hours or more in nonmaternal care—be it day care, nannies, or other family members—the study found 17% showed aggressive behavior. According to the mothers and teachers doing the assessments, that included speaking out of turn, demanding attention, pushing, teasing and fighting. (The word

"mean" doesn't appear on the list—it was used by Belsky.) "These behaviors are distributed at the same level in the general population," says Susan B. Campbell of the University of Pittsburgh, a team member. "These children are completely typical."

What's not typical is that only 6% of the kids in maternal care behaved aggressively—far below the average. But is that because these kids are somehow less aggressive—or because, like all kids, they tend to fight with those of their own age rather than their mothers? "Perhaps there is just limited opportunity for kids not with other children to show some of these aggressive behaviors," suggests NICHD researcher Marsha Weinraub, of Temple University.

Belsky says his fellow researchers are just looking for ways to make parents feel good about leaving their children in care: "People are casting this as though if these [behaviors] aren't severely pathological, it doesn't matter." But if

they are normal, it doesn't. Let's face it—75% of U.S. kids are in child care, and that's not going to change. Far better that we focus on the need for high-quality child care rather than on its overstated dangers.

Senior writer Arnst is a working mother.

Child Aggressiveness Study Cites Day Care

By SHARON VANDERKAM
Washington Post Staff Writer

The study found that toddlers who spent more time in day care were more aggressive than those who spent more time at home.

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both researchers and laymen. That debate was directly on the line at a news briefing yesterday.

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Day care linked to aggression

More hours add to kids' problems

By Marilyn Elias
USA TODAY

The more hours children spend in day care before starting school, the more aggressive they are, says a new study.

less. The new solution is to cut the number of hours that day care is open for the family that may not be beneficial for the development of the children in terms of economic

as well as had the same problems. The average time that children spent in child care between the age of 3 months and 4 years was 26 hours a week.

While these problems were not solved by the quality of the child care, the study's importance is clear.

The study's "don't mean these children are going to get hurt and show people's heads off," Belsky says. Effects of day care are modest, but the fact that so many may be affected makes the study important.

study author instead. It's a simple equation: "As time in day care goes up, so do problem behaviors," he says. "It will report at the Society for Research in Child Development in Minneapolis."

The findings "don't mean these children are going to get hurt and show people's heads off," Belsky says. Effects of day care are modest, but the fact that so many may be affected makes the study important.

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MIXED SIGNALS: A two-person teleconference, not the report, sparked the scare headlines

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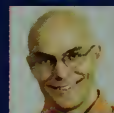
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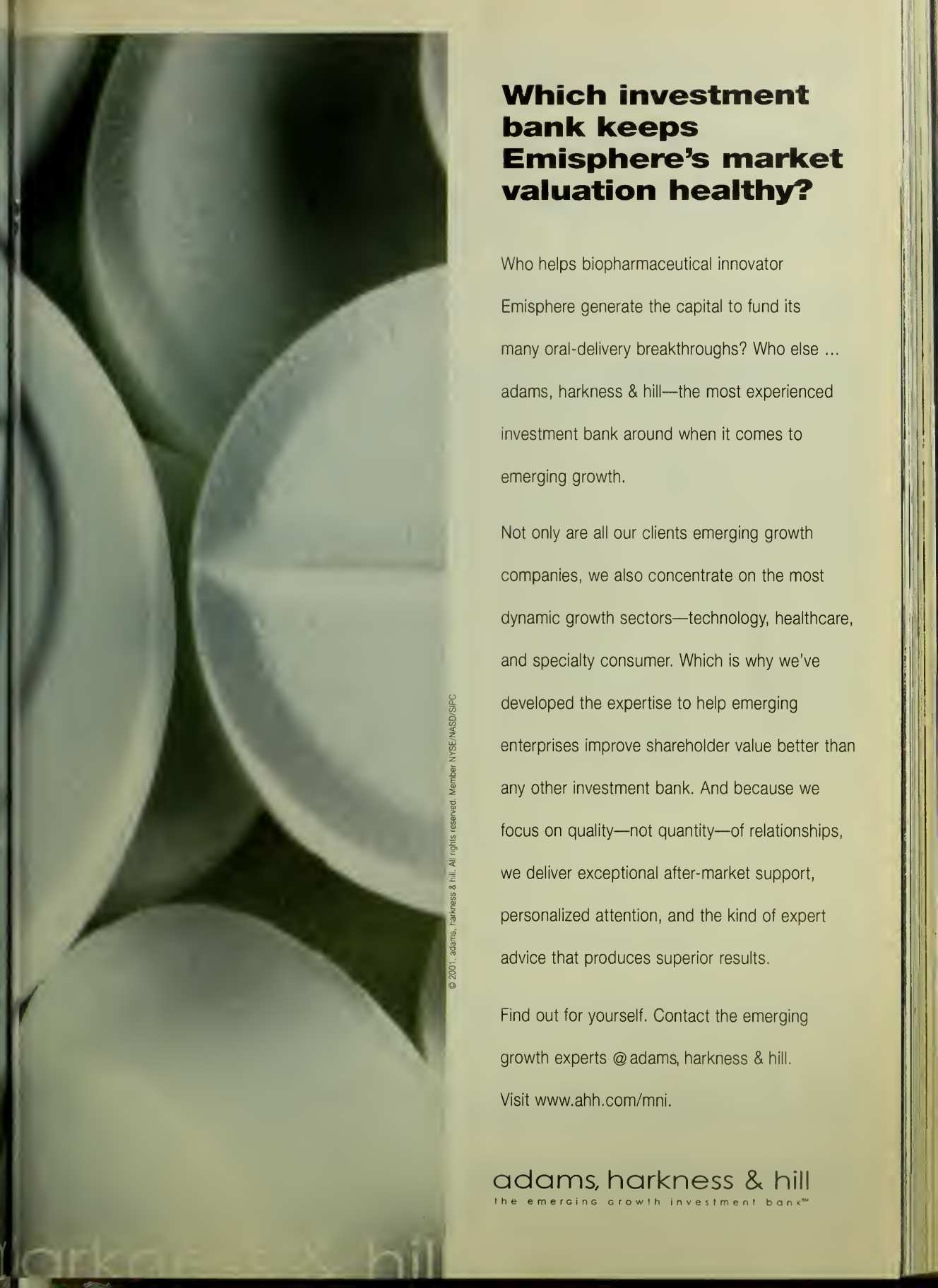
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COMMENTARY

By Jay Weiner

GOD AND MAN AT MADISON SQUARE GARDEN

No matter what the season, Almighty God always seems to be rooting for the winning side.

That's the way it is nowadays, what with athletes of all stripes asserting that the Holy Spirit was perched on their shoulder when: the free throw was made, the home run hit, the touchdown caught, the knockout punch delivered, or the checkered flag waved.

The merging of sports and religion isn't new: Notre Dame has been winning righteously for decades, with "Touchdown Jesus"—a mosaic on the library—overlooking its gridiron. But Notre Dame is a Roman Catholic school.

What is new is the way religion seems to be creeping into all sorts of sports—and this goes far beyond pregame prayers by high school football players. The Church of Jesus Christ of Latter-day Saints, for instance, has donated more than \$5 million to the Salt Lake Olympic Committee and will be a towering presence at the 2002 Winter Games. (In fact, critics are calling the Games the "Mo-lympics" because of the expected influence of the Mormons.) A Christian ministry, Motor Racing Outreach, is deeply involved in NASCAR. And a vocal fundamentalism is now roiling the NBA (page 123).

This ubiquitous relationship between praying and playing took an ugly turn when New York Knicks Charlie Ward and Allan Houston were recently quoted as reasserting the old-fashioned anti-Semitic mantra that the Jews killed Jesus. "They had his blood on their hands," Ward told *The New York Times Magazine*. "Then they spit in Jesus' face and hit him with their fists," added Houston. What's worse, such biased ignorance came in the con-

text of a team Bible study class.

"That's the scary part," says University of Chicago Professor Emeritus and Lutheran theologian Martin E. Marty. "Christian Bible study is where the nuances have to come out. I can see why athletes might embrace forms of faith that issue everything in black and white. But the Bible is full of ambiguity. That seems

besides a commercial logo and an outrageous contract. Just as refreshing, though, is a jock like Tiger Woods who avoids controversy while making a statement with simple, athletic grace. In the best of all worlds, athletes would be God-fearing, not God-trivializing, and would do good work off the field instead of blabbering about how the Lord helps them when the curveball cometh.

Let's be real: Sports reflect and reinforce the values and trends in society. And jocks have opinions just like bus drivers and sanitation workers. It's just that no one grows up wanting to be Ralph Kramden or Ed Norton.

Sports and athletes have power. That's why companies buy ads during televised games and naming rights to arenas. Religions recognize that pow-

er, too. As Billy Mauldin, CEO of Motor Racing Outreach, an auto racing ministry, told *The Washington Post* recently: "If [NASCAR driver] Dale Jarrett drinks Gatorade, [his fans] want to drink Gatorade. And if Dale Jarrett goes to church, they may think about why they're *not* going to church.... And that's especially true with younger people."

So what about Ward and Houston? Are they uninformed zealots, full-fledged anti-Semites, or simply pros whose intellectual and social development has been arrested by an ego-promoting but growth-stifling sports culture? Will their dated and prejudiced beliefs encourage young playground players, hypnotized by three-point shots, to adopt their two-bit views?

These are role models? God forbid.

Weiner follows sports from St. Paul, Minn.



BIBLE STUDY: Knicks link hands in prayer at a scripture session while on the road

to have been all wiped out in their world, where there has to be a winner and a loser."

CLEAR DANGER. The words of Ward and Houston certainly raise questions for fans. And the steady march of religion into professional sports should be cause for concern by Corporate America. For companies that subsidize teams via advertising and hand out endorsement deals to players, the danger is simple: The more religion in sports, the more chances for embarrassing and alienating incidents that turn off consumers or tar a brand name.

In a pluralistic society, just how much do we need to know about the beliefs of star athletes? Yes, it's refreshing to find a player who is articulate and stands for something

EDITED BY MONICA ROMAN

A SHIPYARD MATCH THE NAVY WILL LOVE

GENERAL DYNAMICS HASN'T given up its efforts to buy Newport News Shipbuilding. On Apr. 25, it bid \$2.6 billion, nearly double the \$1.4 billion it offered in 1999. Newport News thought the price was too low last time. The latest deal, which would create a giant that will build all the U.S. Navy's submarines and aircraft carriers, could pass muster with the Bush Administration. Some senior Pentagon officials believe competition should be defined by mission, not hardware. If satellites, spy planes, and submarines compete for intelligence missions, the U.S. doesn't need two shipyards building subs, the thinking goes. The two Virginia defense companies don't compete anymore, anyway—they

split submarine contracts. And the Navy may reap potential savings, given GD's record for slashing costs.

DID ORACLE SEE THIS COMING?

NEXT TIME ORACLE CEO Larry Ellison looks in his rearview mirror, he might see a blue streak speeding up behind him. IBM on Apr. 24 said it would plunk down \$1 billion for the database software unit of Informix. The bid takes aim at the heart of Oracle's business—applications that run on Unix machines. IBM already holds more than 90% of the market for databases that run on mainframe computers. With Informix, IBM will have 22% of the Unix market. That's well shy of Oracle's nearly two-thirds share, but Ellison might want to hit the gas pedal to stay ahead.

CLOSING BELL

HOT STEEL

Fifteen years after U.S. Steel and Marathon Oil were subsumed into USX, the Pittsburgh company has decided to split the two. Investors cheered the move, which could occur by yearend. Why? As a stand-alone entity, U.S. Steel could attract a takeover bid. USX-U.S. Steel shares, now traded as a tracking stock, leaped 19% on Apr. 24, to \$18.90, before slipping to \$18.70 the next day.



J.P. MORGAN'S NOVEL VC PLOY

IT'S ANOTHER STRANGE SIGN of the times. J.P. Morgan Chase is turning to the bond market to raise venture-capital funding. The New York bank plans to sell \$600 million to \$800 million of AAA-rated bonds to finance more than 100 venture-capital, private equity, and leveraged buyout deals. The bonds will pay 6% interest, plus periodic cash payments based on investment performance. A third of the investment will be in existing partnerships with the bank's private equity unit, says Bloomberg News, which first reported the story.

ONE WAY TO SNUFF OUT A SUIT

TOBACCO FRIENDS AND FOES alike have long assumed the Bush Administration would find the first exit from the \$100 billion lawsuit against

HEADLINER: LAWRENCE JOHNSTON

UP THE FOOD CHAIN

LAWRENCE JOHNSTON MAY be getting out of General Electric at the right time. As chief of GE's home-appliance unit, he has been duking it out with Whirlpool and Maytag. But sales and profits are slumping as the industry flounders.

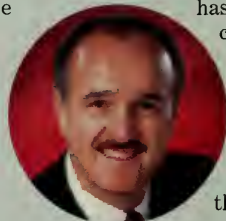
Johnston, 52, is leaving that frying pan only to step into another, however. Albertson's, the nation's No. 2 supermarket and drugstore chain, named Johnston chairman and CEO on Apr. 24. Ever since it bought American Stores in 1999, Boise (Idaho)-based Albertson's has been losing market share

to megachains Kroger, Safeway, and Wal-Mart.

Johnston's hire marks the first time Albertson's has gone outside the company for a CEO. He figures his outsider status gives him an edge. "I don't bring any baggage to this thing, so I can tell you right now there are going to be no sacred cows," he says.

It's about time, analysts say. "Albertson's is a company that needs a breath of fresh air," notes John Murphy of Credit Suisse First Boston. Still, Johnston may be in for his toughest fight yet.

Julie Forster



Big Tobacco it inherited. That exit may come sooner than expected. Before taking a formal position on the suit, Administration officials have found a way to quietly smother it. Bush's first budget provides just \$1.8 million of the more than \$56 million that prosecutors say they need to continue the case. The idea is not new: Republican congressional leaders tried to slash funding during the Clinton years.

A SETBACK FOR VANGUARD

A FEDERAL JUDGE GRANTED A permanent injunction on Apr. 25 to The McGraw-Hill Companies barring Vanguard Group from issuing exchange-traded mutual funds based on Standard & Poor's indexes. ETFs are index funds that trade mostly on the American Stock Exchange. McGraw-Hill, which owns S&P and

BusinessWeek, sued to prevent Malvern (Pa.)-based Vanguard from launching the products, dubbed VIPERS. McGraw-Hill argued that the nation's second largest mutual fund company didn't have the proper licensing agreement to use the S&P name. Judge Alvin Hellerstein agreed. Kenneth Vittor, McGraw-Hill's general counsel, called the decision a "vindication." Vanguard is taking issue with the ruling: "It is our intent to file an appeal at the earliest opportunity," a Vanguard spokesman said.

ET CETERA...

- Standard & Poor's downgraded California's debt due to the state's energy crisis
- Telecom company Verizon cut its annual capital budget by \$1 billion, to \$17.5 billion
- Sun Microsystems will shut down for a week this summer as a cost-cutting move

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EDITED BY PAULA DWYER

HOW LONG WILL THE DEMS CARRY THE TORCH?

They call him "the Torch." In four years as U.S. senator from New Jersey and 14 years in the House, Democrat Robert G. Torricelli has burned bright. But along the way, he has scorched friends and enemies alike.

Now, as federal investigators zero in on Torricelli's campaign finances, the Torch is feeling the heat. So is the Democratic Party, which, for the moment, is rallying around the battered lawmaker—in part to safeguard the 50-50 split in Senate. Torricelli faces voters again in 2002, and so far

New Jerseyites are not abandoning their colonial senator. All that could change if he is indicted, but Torricelli is a fighter.

The case against Torricelli centers on David Chang, who pled guilty last year to making illegal contributions to Torricelli's '96 reelection effort. Now Chang claims he gave the senator gifts and cash in return for helping win big international business deals. Torricelli says he has done nothing illegal and denounces Chang as a convicted felon fabricating stories to reduce his sentence. Chang's lawyer declined to comment.

ETHICAL GAME. The key political question is whether Torricelli can hold his seat with such an ethical cloud overhead. The 2002 elections are crucial to Dems, who need one more vote to control the Senate. "The situation makes it difficult for Democrats in our state," says Democratic ex-Senator Frank R. Lautenberg of New Jersey, an admitted Torricelli foe. "A negative outcome would certainly have an effect on the party and the chances for next year."

What's a party to do? In this case, wait it out. Manhattan U.S. Attorney Mary Jo White has not told Torricelli that he is a target of the probe. Indeed, legal experts say the case could continue for years. "The party can't abandon him. He hasn't been charged with anything," says Joseph E. diGenova, a Reagan-era prosecutor. "They have to walk a tightrope."



TORRICELLI: Ethical cloud

Torricelli pled his case at an Apr. 24 meeting of Democratic senators. Afterward, he described the exchange as "heartening" and his party as "very supportive." Beyond that, it has been business as usual for the Torch, who's still hot on the fund-raising circuit. His campaign had raked in \$2.5 million by Mar. 31—more than any other senator.

Yet the case is taking its toll. New Jersey has been trending more Democratic—an Apr. 22 (Newark) *Star-Ledger* poll found that 42% of voters would support Dems this year,

while 33% would vote Republican—but that hasn't translated into new support for Torricelli. A Republican poll in March gave Torricelli only a slight edge over possible GOP opponent Bob Franks.

So far, potential primary rivals, including Representative Robert Menendez (D-N.J.), say they have no plans to challenge Torricelli. And among the party faithful, there's not even a whisper that he should resign—though that could change if a Democrat replaces acting GOP Governor Donald T. DiFrancesco in November. On Apr. 25, DiFrancesco, facing his own ethical problems, declined to run for a full term. "[Torricelli is] paying close attention to his race, he's engaged and completely focused," says Jim Jordan, executive director of the Democratic Senatorial Campaign Committee, which Torricelli ran from 1998-2000.

Even Republicans concede that there are high legal hurdles. The U.S. Supreme Court set the standard in 1999 when it threw out an illegal gratuities case stemming from the prosecution of ex-Agriculture Secretary Mike Espy. Now prosecutors must show that pols performed favors in exchange for gifts. "It's hard to make a case," says Jan Baran, former general counsel to the Republican National Committee. Legally or politically, it won't be easy to snuff out the Torch.

By Lorraine Woellert

CAPITAL WRAPUP

TAX REFUND NOW?

Pressure to squeeze up to \$85 billion of immediate tax relief into President Bush's long-range rate cuts is forcing Treasury Secretary Paul O'Neill to be creative. One idea he's floating: a retroactive tax cut that would produce additional refunds for just-filed 2000 tax returns. Rather than a per capita rebate—the Democrats' pet idea—the ideal is an early implementation of the rate cuts," retroactive to Jan. 1, 2000, O'Neill says.

The notion could help the Adminis-

tration solve two problems. The Bush team fears that if Congress passes a rebate, the President's 10-year tax cut will stall. Tying refunds to rate cuts, strategists figure, creates a seamless plan that Democrats can't split up.

The other problem is how to distribute the stimulus, even if House-Senate negotiators cut it to \$60 billion as expected. If the IRS tries to dole out that much cash by reducing workers' withholding retroactive to January, take-home pay would shoot up this fall, only to drop back when the permanent

rates kick in. That would create the appearance of a tax hike, which both Bush and Congress are eager to avoid. So Treasury figures it will need a mix of lower withholdings and refund checks. Basing those refunds on 2000 tax returns "gives life to the idea of rate reductions," O'Neill explains.

Still, the idea faces hurdles. Dems are dismissive. And refunds pose a logistical challenge: Treasury's printers would take almost six months to produce the required 125 million checks.

By Mike McNamee

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A LONG ROMP FOR THE SHORTS?

Short sellers say the bear market has a ways to go

On Apr. 19, Michael J. Saylor, the flamboyant chairman of MicroStrategy Inc., sent a highly unusual and urgent letter to his company's shareholders. "Management believes that the current stock price is attributable in part to heavy selling pressure from short selling in the marketplace," he wrote. The stock's sharply diminished price—it traded as high as \$313 a share in March, 2000, and as low as \$3 in mid-April—no doubt led Saylor to point the finger at the diabolical short sellers. Truth is, MicroStrategy has been a short seller's dream for many reasons, including a Securities & Exchange Commission probe that resulted in a heavy penalty and aggressive accounting practices that forced the company to restate three years' worth of earnings.

Saylor's blame game reveals the success and influence short sellers are enjoying in a bearish market. Shorts sell borrowed stocks with the hope of buying them back as the stock price falls. They are famously discreet for fear of being kept off company conference calls or worse, attracting lawsuits and even death threats. These days, they have a glut of targets—some are tech companies, but many are in other areas such as biotech, energy, and retail. Typically, these are companies that should have never gone public, shorts say, or are

simply suffering because of a severe downturn in capital spending. "Most marginal companies aren't getting financing going forward, so troubled balance sheets and negative cash flows are taking up more of our attention these days," says the famous short seller James Chanos of Kynikos Associates.

Short-selling hedge funds were up 13.4% in the first quarter of this year and 18% in 2000, beating out all other hedge fund categories, according to Zurich Capital Markets Inc. And short interest on the Nasdaq and New York Stock Exchange remains at record levels.

UNFAZED. Shorts are counting on a continuing bear market to bolster their bottom lines. They pay little heed to gurus who say the market has bottomed out and the tech slump is nearing an end. Shorts point to sour earnings projections, at least through year's end,

and a weakening U.S. dollar that could spur inflation. The recent rally has left some shorts unfazed. "It was partly based on buyers' panic—investors who didn't want to miss the boat—and short-covering, making for a largely artificial advance and no lasting fundamental change in stock prices," says Douglas Kass, manager of Seabreeze Partners and Kass Partners, both short-biased hedge funds.

Just because shorts are strutting

SHORT FUNDS, TALL GAINS

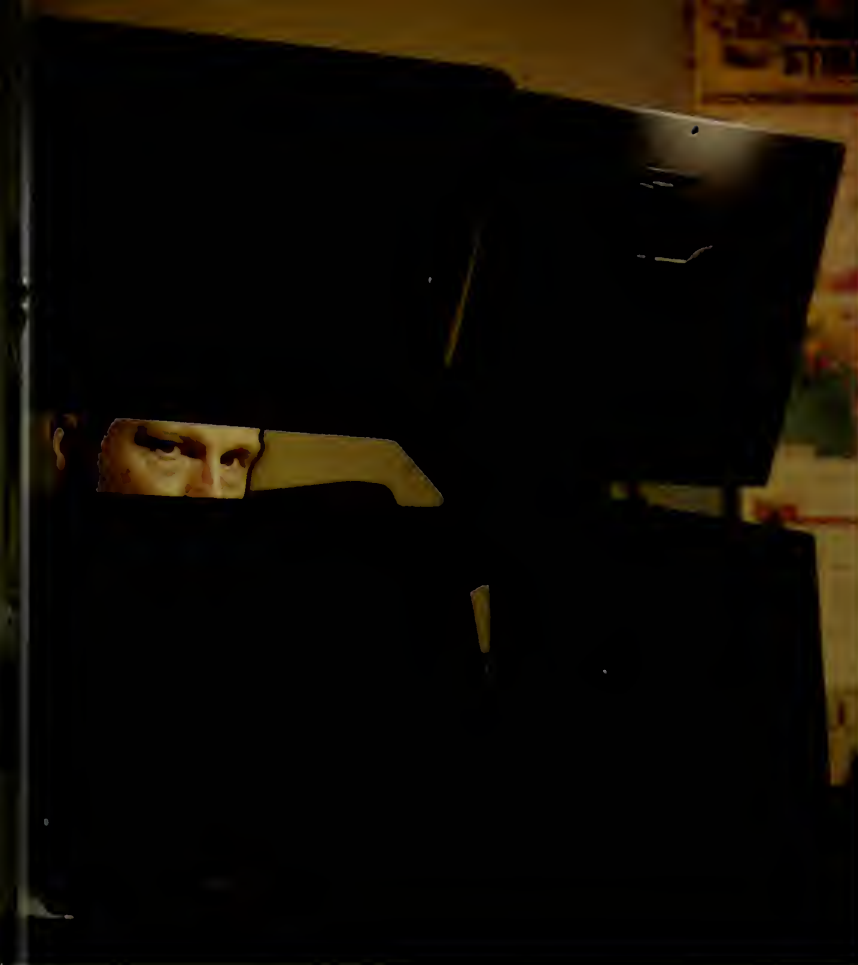
HEDGE FUND	1ST QUARTER	PAST 12 MONTHS
SHORT ALPHA BEAR	39.61%	59.59%
REYNARD AMERICAN PARTNERS	18.87	56.42
ARCAS FUND II (ARCAS INTERESTS)	17.46	158.62
PEREGRINE INVESTMENT PARTNERS	17.39	81.47
ARCAS COVERED FUND	12.80	169.53
BAY RESOURCE PARTNERS	7.94	33.30
WATERLOO PARTNERS	6.10	31.46
COMPASS HOLDINGS	5.08	41.20
DANCING BEAR PARTNERS	4.39	11.36
ROCKER PARTNERS	3.27	39.35

Data: Zurich Capital Markets Inc.

right now doesn't mean they will stumble again soon. After all, not long ago they seemed as doomed as many of the companies they now target. The bull market led many big short sellers, such as the Feshbach Brothers of F&B, Alto, Calif., and Brookline Capital's A Fenster, to abandon their short strategies or go out of business. In fact, says Harry Strunk, a Palm Beach, Fla., investment consultant who tracks short-only managers, the number of pure short sellers has fallen from 19 in 1999 to just 6. Shorting proved ruinous even George Soros, who bet against tech stocks during the bull market.

But all that has changed—at least for now. "The excesses in the market took many, many years to build up, and people think it can be fixed in matter of months or weeks, but it will take time," says Marc Cohodes, a general partner at Rocker Partners LP, a short-biased hedge fund that was up 39% over the past 12 months. Meanwhile, companies continue to play new games, says Cohodes, who points to Cisco System Inc.

These days, there's a wealth of companies to target



BEAR HUNT: *Hedge fund manager Brian Rogers is watching biotech*

value, are a good target, as are energy traders along the lines of an Enron Corp. or a Dynegy Inc. While Chanos won't confirm his specific shorts, he points out that these stocks are essentially giant energy hedge funds that are trading at huge valuations. He's also interested in high-growth retailers that he thinks can't sustain 50% annual growth. Chanos has shifted his focus significantly from a year ago, when he was looking at the Internet and telecom ideas.

GUMSHOES. Good ideas don't come just from short sellers. Short researchers pore over balance sheets and sell their findings to hedge funds and money managers. For these financial gumshoes, who often charge into the upper five figures annually for their services, business is booming. "Hedge funds are realizing the only way they can make money and justify their fees is on the short side," says Howard Schilit, an accounting expert. Likewise, money managers who don't short are turning to Schilit to warn them of potential blow-ups in their portfolios. "People who said thanks,

but no thanks a few years ago are now calling and saying, 'Help me,'" he says. Schilit, a former accounting professor, is famous for ferreting out some of the biggest accounting blowups in recent years, including Sunbeam Corp. and Oxford Health Plans Inc.

Another prominent researcher is Mark Roberts, director of research for Off Wall Street Consulting Group Inc. He employs seven analysts, all of whom have accounting backgrounds or have run businesses. Roberts suggested shorting priceline.com Inc. when it was trading at \$111—a prescient move, it turned out. One of Robert's current favorites is the medical sector. "A lot of these companies, especially biotechs, acquired a lot of financing and when that dries up they're toast," he says.

Some may argue that when the bear market comes to an end, short sellers will perish along with it. But at least for now, the bears are gleefully rolling around in the mud.

By Marcia Vickers, with David Henry, in New York

ent inventory write-off. "If you're in the meat business and you write off that, you're still going to sell that meat. It's a total spin job," he says. A Cisco spokesman says, "We simply have no idea for that inventory, otherwise we wouldn't be writing it down."

Cohodes doesn't usually short large companies such as Cisco because, he says, they will be around cycle in, cycle out. Instead, he looks for what he calls "busts, frauds, and failures." Some current broad themes: companies that support the state of California with power and semiconductor companies that have run up in recent weeks. More narrow bets include shoe manufacturer Skechers USA Inc. Says Cohodes: "It's a fad—fashion shoes trying to be high-fashion." Cohodes also notes that Skechers is run by Robert Greenberg, former chairman of L.A. Gear, which reorganized for bankruptcy in 1998. Cohodes has also been short on QLogic, a computer component maker, for some months. "In the last quarter they saw receivables and inventory go through the roof," he says.

Some shorts are focusing on what they believe are overvalued companies. Brian Rogers, manager of the Short Alpha Bear hedge fund, the top-performing short-only fund in this year's first quarter, says: "I think current valuations—the average price-earnings ratio is around 25—indicate we are nowhere near a market bottom." Rogers targets larger, more liquid companies and uses both fundamental and technical analysis. He says most other short sellers focus primarily on smaller companies that are likely to go out of business. "Most shorts tend to invest in the same small companies, so often there's a short squeeze and all the funds go down together," he says. Some past shorts include Motorola Inc. and Starbucks Corp. A favorite target right now is the biotech industry. "The price-to-sales of the industry is very high," he says.

Kynikos' Chanos, whose fund was up 35% last year and 12% through March, is on the prowl for overvalued sectors. He says subprime lenders, which are trading at as much as five times book

es continue to slow and financing starts to dry up

HEDGE FUNDS: LET THE BAD TIMES ROLL

Many who bet on a down market are thriving these days

How well did hedge funds do in the latest quarter? That all depends on what you think their job is. Traditionally, hedge funds are supposed to produce positive returns, after fees, even in the toughest of circumstances. Only about 60% managed to do that in the teeth of a vicious first-quarter bear market, according to Greg Newton, president of *MAR/Hedge*, a newsletter that tracks hedge-fund investments. On the other hand, fully 86% beat the Standard & Poor's 500-stock index, which fell 12.1%. As far as Newton is concerned, that's pretty good: "The comment I keep making to anyone who will listen is that, generally speaking, in market conditions like the one we had in the first quarter, a substantial majority of hedge funds are going to outperform benchmarks."

Hedge funds are lightly regulated investment partnerships that are open only to wealthy investors, with a typical minimum investment of \$500,000 and a wide range of investment strategies, including short-selling. Fund managers get most of their money by taking a 20% cut of the profits. Not surprisingly, funds that make bets on stocks falling—so-called "net short" funds—were the quarter's hottest performers, with the median fund in the category up 13.4%, after fees, according to *MAR/Hedge*, whose database was recently acquired by Zurich Capital Markets Inc. Last year as well, short funds did best, posting 18% returns.

On the flip side, with the Nasdaq Composite Index down 25% for the quarter, hedge funds specializing in technology investing performed the worst. For instance, Essex High Technolo-

ELITE RACE:
For a big cut of the profits, the funds try to make money in any market



gy Fund, which had returns of 122% in 1998 and nearly 400% in 1999, lost 61% in 2000 and another 30% in the first quarter, according to *MAR/Hedge*.

So did tech-heavy hedge funds fail because they didn't have positive returns? Not according to many observers. After all, most did better than Essex. The median tech hedge fund was

down 11%. "Spectacular performance is always relative. In this context, 11% losses compared with 25% losses for Nasdaq is a reasonably spectacular performance," says Newton. Some did even better. Pequot Technology Fund, a member of Pequot Capital Management's multibillion-dollar hedge-fund family managed by Dan Benton, actually earned 11%.

Circumstances had a

lot to do with which funds did well. The market was cruel to the "close longs," which purported to be hedged against a down market but weren't. In contrast, it was a good quarter for funds specializing in convertible arbitrage, which buy convertible bonds of companies while selling short the company's stock as a hedge. With the Federal Reserve pushing down interest rates at the same time stocks fell, the funds made money both on their long

positions in bonds and their short positions in stocks. Highbridge Capital Corp. is a top convertible arbitrage player with \$3.5 billion under management, had 5% return in the quarter.

SUPERTANKERS. Many large funds struggled in the first quarter, proving that bigger may not be better. One of the biggest losers was Zweig-I-Menna, a long-shot U.S. equity fund with more than \$5 billion in assets. It was down 19% for the quarter, compared with losses of 5% last year. A Zweig-I-Menna spokesperson says the fund is counting on rate cuts

to boost the market and push it into the black. Another giant, Maveron Fund, with \$4.7 billion in assets, was down 1% for the quarter, compared with 28% returns last year. Big funds can sell their huge holdings quickly when they see the market moving against them. "There really is a difference managing large funds. It's like trying to steer a supertanker vs. a nice nimble boat," says Nicola Meaden, CEO of Tremont TASS Europe Ltd., a research and advisory firm.

Still, most hedge-fund managers are feeling pretty good about themselves lately, after a string of years in the late '90s when they met their goal of producing steady gains but were faulted for falling short of the roaring S&P 500. "We've always said the real test for hedge funds is in bear markets," says Elizabeth R. Hilpman, partner of Blylow Partners in New York, which invests in several hedge funds. "So far, they've passed that test with flying colors." Too bad only the rich can play.

By Debra Sparks in New York

BEATING THE S&P

Median percentage change*

	FIRST QUARTER 2001	FULL YEAR 2000
NET SHORT	13.4%	18.0%
LONG/SHORT	3.3	16.4
DISTRESSED	1.8	5.5
RISK ARBITRAGE	1.5	14.3
GLOBAL MACRO	1.4	7.5
TECHNOLOGY	-11.3	-6.8
S&P 500	-12.1	-10.1

*Returns net of fees

Data: Zurich Capital Markets Inc.

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Warren Hellman's firm is making Buffett-like plays

What do the Nasdaq, race cars, and bottled water have in common? Not much—unless you're F. Warren Hellman, chairman of San Francisco-based investment group Hellman & Friedman LLC, one of a handful of firms cleaning up at a time when most are picking up the scattered pieces of the tech mess. Indeed, the private-equity firm has been so strikingly successful

terrific business franchise," he says.

However, some analysts believe the investment could disappoint. If Nasdaq fails to hit the public market, Hellman's firm may be stuck holding its 4% convertible five year notes with no buyer in sight. "The question is: What's the exit strategy?" asks Jesse Reyes, vice-president of global product management for Venture Economics. Counters Patrick

man's close-knit team now runs the funds that have raised \$4.5 billion and have returned a net average of more than 30% to investors. Hellman founded his firm in 1984 with Tully Friedman, who left to start his own firm in 1993.

Hellman & Friedman first made its mark in 1985 with the \$1.8 billion buyout of blue-jeans maker Levi Strauss & Co. When Hellman completed his second buyout of Levi Strauss in 1993, investors saw returns of as much as 10 times on their original investment. The firm has proved to be a shrewd, disciplined investor many times over since then. Three months after picking up a 37.5% stake in Formula One Holdings in 2000, the firm flipped its \$312 million investment for a nifty \$280 million profit. Then, it walked away with an \$11 million return on a \$243 million investment in ad agency Young & Rubicam.



AGAINST THE GRAIN: Hellman (second from right) and his colleagues—"smart, contrarian investors"

lately that some investment partners and rivals consider Hellman the Warren Buffett of the West Coast. Besides sharing the same first name as the Berkshire Hathaway Inc. billionaire, Hellman has gained a reputation for unearthing value in such eclectic investments as the racing-circuit franchise Formula One Holdings Ltd. and Australian water bottler Neverfail Bottled Water Ltd.

Now he is shelling out \$240 million for debentures that, once converted, will amount to a 9.8% stake in the Nasdaq Stock Exchange. Hellman is betting that if the exchange successfully breaks free from the National Association of Securities Dealers, its primary owner, for a possible public offering, the firm's piece could earn a return of more than 20%. Hellman is counting on Nasdaq's listing to be just as successful as the recent initial public offering of the Deutsche Börse exchange in Frankfurt. He also likes Nasdaq's roughly \$500 million in cash reserves and its strong growth prospects. "Simply put, Nasdaq is a

J. Healy, the partner overseeing the investment: "When you make a good investment, you literally don't have to worry about the exit, because it takes care of itself."

MARATHON MAN. Hellman is down-to-earth and approachable, with his tie askew and hair sometimes slightly out of place. But don't confuse disheveled with laid-back. His understated demeanor belies competitiveness. Once, Hellman tripped at the one-quarter mark of a 100-mile ultramarathon and broke a rib. He got up and completed the remaining 75 miles. Hellman has tattoos of his horse and his company logo adorning his leg and arm.

Observers expect that Hellman & Friedman will soon make more investments in addition to their stake in Nasdaq. Hell-

man just before the shop went public in 1998. "They are very smart, contrarian investors," says Rick Hayes, who oversees private equity investing for the California Public Employees' Retirement System, a pension-fund giant and a longtime Hellman partner.

That's not to say there haven't been some missteps along the way. In 1997, the firm lost nearly all of a \$100 million investment in paging company MobileMe when it went bankrupt. Hellman says that early mistakes helped the firm shift its focus from looking for fast deals to seeking good investments. Hellman can spin gold from blue jeans and water bottles, Nasdaq may not prove too daunting a challenge.

*By Douglas Robson
San Mateo, Calif.*

F. WARREN HELLMAN

BORN New York City, 1934

EDUCATION University of California at Berkeley, Harvard Business School

CAREER Joins Lehman Brothers in 1959; becomes president in 1973. After serving as a general partner with venture-capital firms, co-founds Hellman & Friedman in 1984

HOBBY Horseback riding



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IT'S A DIFFERENT KIND OF WORLD.
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By Christopher H. Schmitt

The predictions from the securities industry were dire indeed last August. The Securities & Exchange Commission had just approved a new rule that if companies disclose information important to investors, they must share it with the world and not just a favored few on Wall Street. The industry warned that the rule would have a chilling effect that would actually slow the flow of information to individual investors. Fearful of liability stemming from mishandled disclosures, companies would simply opt to say little.

Well, forget about that. Six months have passed since Regulation FD—for “fair disclosure”—went into effect, and the sky has definitely not fallen. Evidence is accumulating



that Reg FD is a smashing success, maybe working better than supporters hoped. There could be room to fine-tune the rule. But it seems clear that Reg FD is quietly achieving the revolution intended by the departed SEC Chairman Arthur Levitt Jr., whose attack on selective disclosure—he called it a stain on U.S. financial markets—was a part of his investor-protector

In a recent survey, the Investor Relations Institute found that 28% of its member companies are providing more information to analysts and investors than they did before the IPO effect and that an additional 25% have not cut back. A Price houseCoopers survey of 16 publicly held tech companies last

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it only that many are disclosing information more frequently but have incurred significant costs.

Coker, who tracks earnings calls for his BestCalls.com Web site, points to a dramatic change. Two years ago, more than 75% of companies holding conference calls excluded individual investors; today, virtually all are open to them. He also finds that companies are saying more on the calls, not less. He says they're beginning to provide interim quarterly updates. "I think any of us in the industry underestimate a dramatic impact Reg FD will have," Coker says.

VOICE. As impressive as these developments may be, Reg FD's ultimate test may be that it builds an expectation of openness. Companies will disclose more if they don't want to be at the hands of investors. J. Eccles, senior fellow at the Center for Corporate Governance, puts it this way: "Two companies are performing equally well, but one is more forthcoming about which one are you going to invest in."

Investors are allowed to join conference calls, and companies are saying more during the sessions

Faced with evidence of Reg FD's success, critics acknowledge there are more corporate announcements today, and that information is more widely available. But at an SEC hearing in New York on Apr. 24, they complained that the quality of the information is down because companies are reluctant to add extra detail to boilerplate disclosures scripted in advance. It's important to remember, however, that much of this sentiment comes from analysts, who probably suffer the most under Reg FD, with loss of privileged access to company management. Most important, the complaint is bogus: Reg FD doesn't bar releasing extra details,

it just says that if information goes out to one, it must go to all.

With the new Bush Administration and its less-is-more approach to regulation, some in the securities industry hoped the SEC would pull back on Reg FD, especially since the agency's current acting chair, Laura S. Unger, voted against Reg FD last year. But that's highly unlikely, considering the growing support for the rule.

Instead, what the SEC should do is consider modest tweaking that would encourage even better disclosure. Laguarda, who has clammed up rather than risk liability would probably see their comfort zone expand if given more guidance on how to comply. Better guidance on what constitutes "material" information—that is, the kind that if disclosed, must be shared with the world—would also be helpful.

None of this should take away from Reg FD's success so far. And given the market turmoil of recent months, it comes not a moment too soon.

Schmitt covers finance from Washington.

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MBA PROGRAMS ARE GOING BACK TO SCHOOL

A new crop of deans faces pressure to improve the way B-schools prepare grads for a complex workplace

As he prepares to take over this summer as dean of Duke University's Fuqua School of Business, Douglas T. Breeden has taken to reflecting on his own B-school days. By the time he graduated from Stanford University's Graduate School of Business with a PhD and launched Smith Breeden Associates Inc., a money management company, he was armed with the basics, from a business plan to a laundry list of contacts. But as his business grew, running it got harder. He wasn't sure how to structure the company as he added people, or how to inspire staff. Breeden found himself wishing he had gotten more out of those organizational behavior classes. "At the time I took them, they didn't make sense to me, they didn't apply," he recalls. "But 10 years later, I needed them."

That insight led to an idea Breeden will push at Fuqua: lifelong learning. Since MBAs can't possibly absorb everything in a two-year program, they need an institution that will keep teaching them well into their careers. Though Fuqua already has seminars for alums, Breeden wants to make such programs a staple there. "Things are changing at such a rapid pace that if you don't continue to study, you'll fall behind," he says.



FUQUA'S BREEDEN WANTS HIS MBAs BACK FOR MORE

As part of a new crop of deans taking the helm at top B-schools across the country, Breeden and his colleagues are beginning to experiment with the venerated MBA program. Some are tapping into their executive programs for ways to keep alums coming back for more. Others are ratcheting up the use of on-line material to make more time for apprenticeship-type work and issues like ethics and public policy. Some are expanding more overseas, while alliances like the one under discussion by Har-

vard Business School and Stanford Graduate School of Business, which merge their executive education programs (BW—Apr. 30), are catching up. The efforts all come as the deans face a growing chorus of criticism that has them questioning whether management education is keeping up in a rapidly changing business environment.

FEELING THE HEAT. They're under increasing pressure to find the answers. Companies have begun complaining to MBAs, while well-informed, often la-

WHAT'S NEXT FOR B-SCHOOLS?

MBA programs are facing pressure to be more relevant to business. Some efforts now under way:

LIFELONG STUDY

The MBA program, rather than the be-all and end-all, is the start of a long relationship with a school. At Duke and Kellogg, grads are returning for refueling.

GLOBALIZATION

Skip the lip service, and put professors and students on the ground in lesser-known countries. Columbia Business School has sent faculty to the Balkans.

REAL LIFE 101

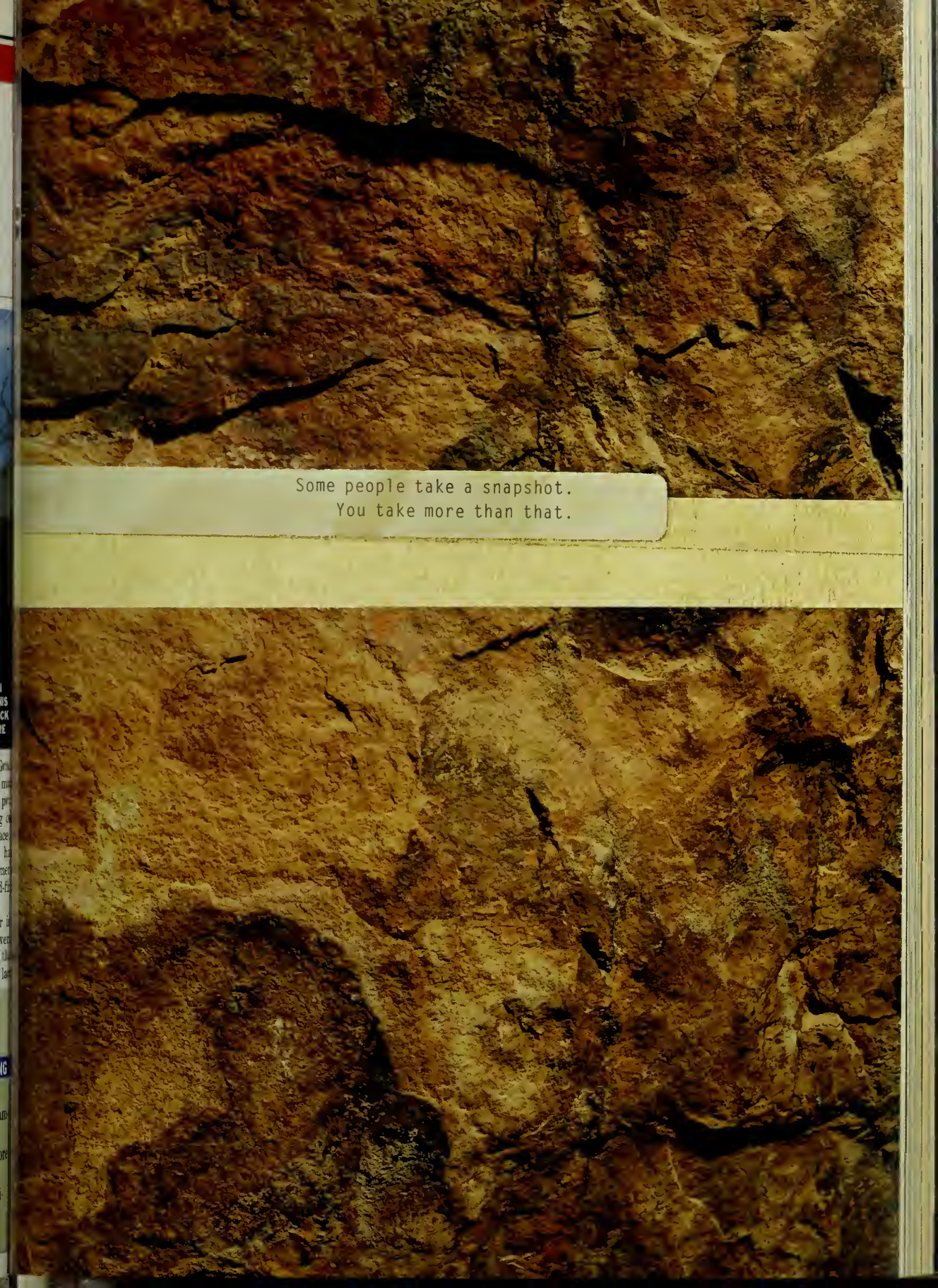
The case study is a venerable tool, but nothing beats facing real problems under the watch of a professor. Students at Arizona State work for Microsoft and Intel.

OUTSIDE THE BOX

Teach MBAs about the intersection of business and policy, ethics, and the environment. MIT's Sloan School is trying to incorporate these issues in every class.

ONLINE LEARNING

Invest in online curriculum to streamline nuts-and-bolts courses, leaving more classroom time for key issues like decision-making and leadership.



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the experience and judgment needed in an unpredictable environment. Meanwhile, university officials are keeping schools tethered to traditional notions of scholarship. Add to that growing competition from e-learning outfits and the new programs abroad, particularly in Canada, where B-schools are shaking off traction (page 70), and America's B-schools find themselves at a crossroads. "The model has to change," says Donald P. Jacobs, who will soon retire after 25 years as dean at Northwestern's Kellogg Graduate School of Business.

Feeling the heat, a handful of schools like Kellogg and Tufts are figuring out that lifelong learning for MBA grads not only fills a need but also fosters alumni loyalty—not to mention revenues. "The concept that in your two years here we cram everything you need to know into your head is crazy," says Patrick T. Parker, dean of the University of Pennsylvania's Wharton School since 1999. Wharton and several other B-schools want to retool their fancy finishing-school models and try bringing alums back to campus regularly for mini-courses. They would be similar to those already offered to executives designed just for their alums.

HERE TO STAY. That doesn't mean the two-year MBA is going away. Rather, the concept is to give students the basics, such as finance and marketing, plus a healthier dose of nonbusiness subjects during their time on campus. Classroom time would be split between the need-to-knows and squishier things, such as leadership and global awareness. Apprenticeships or consulting work would add to real-world knowhow. Then grads would be brought back later for what they need along the way, such as organizational management and senior-level decision making—a kind of "midair refueling," says B. Joseph White, outgoing dean of the University of Michigan Business School.

To do that, schools will likely turn to their executive education departments, which have a long history of teaching midcareer execs and managers but haven't usually served their own MBA alums. With many schools boasting an alumni base of tens of thousands, partnerships like the one between Harvard and Stanford will be key.

HANDS-ON EXPERIENCE

Part of Wharton's changing MBA curriculum involves a weekend fixing houses for the poor



If learning continues over the course of an entire career, then the MBA program itself could put more emphasis on a broader approach to business. "None of us is very good at teaching the context of business," admits outgoing Fuqua Dean Rex D. Adams. Adams' attempt to provide context has been to champion global topics, creating an MBA earned with class time on several continents. That was a hit with multinationals, which generally haven't been happy with U.S.-centric MBA grads. "People are coming out of good business schools who don't understand the international issues they're going to deal with from day one," says Rhonda Germany, a vice-president in Booz, Allen & Hamilton Inc.'s Chicago office. So B-schools are beginning to send faculty to study business abroad. University of Virginia's Darden Graduate School of Business wants students, too, to work and not just study overseas.

Seeing the value of real-life experience, B-schools are also starting to push their students out of the ivory tower nearer to campus, too. "Students can

make the right analysis, but how to implement that analysis takes much more worldly experience," says Jim Beirne, director of MBA recruiting at General Mills Inc. Arizona State University's College of Business, for instance, sends teams of students to consult with local businesses under the watchful eye of a faculty member. One recent project: helping a large utility figure out its capital costs and strategy under deregulation. At Wharton, students learn about leadership by attending a Marine Corps boot camp led by military instructors. For a taste of problems outside the suit-and-tie set, Wharton students spend a weekend fixing houses in poor neighborhoods.

Another missing ingredient: subjects such as ethics, the environment, and public policy. B-schools mostly have relegated those topics to unpopular electives or a few words in a case-study discussion, something corporate recruiters have begun to grumble about. "A lot of students still perceive ethics as an altruistic, moralistic approach instead of as a tool," says David Gebler, president and founder of Working Values Group Ltd., a Boston-based consulting firm that specializes in business ethics. But nowadays, a number of schools are trying to incorporate these things into nearly every course.

Putting more mundane coursework online is one way B-schools are making time for innovations. For example, placing those last two problem sets from a finance course online could mean 20 extra minutes for meatier issues. Some schools are also requiring that students do online coursework the summer before they start their MBA program.

None of these changes has yet taken hold industrywide; academic institutions are slow to evolve. Consider that the last big B-school trend—teamwork instead of the old sharp-elbows approach—came 20-odd years ago. But B-schools face a continuing erosion unless they adapt. That means they'll have to act more like the successful businesses they teach about—or end up like the ones they criticize as missing the boat.

By Jennifer Merritt in New York

BusinessWeek online

For a listing of MBA rankings and profiles, along with other B-school information, see www.businessweek.com/bschools

CANADA: NIRVANA FOR MBAs?

Henry Mintzberg is on a rant about business education. "MBAs should be stamped with a skull and crossbones that reads, 'Not Prepared to Manage,'" the McGill University business professor declares.

What Mintzberg offers up instead is his unorthodox International Masters Program in Practicing Management (IMPM). Founded in 1996 by McGill and five international B-schools (including France's INSEAD and the Indian Institute of Management-Bangalore), IMPM puts 40 midcareer students from Fujitsu Ltd., Lufthansa, and elsewhere through a 16-month course on leadership. Rather than focusing on technical subjects, it tackles students' "mindsets"—one two-week module is called Managing Self. The path to management nirvana weaves students through meditation, acting, journal writing, and trips to primitive and high-tech businesses. "It teaches you to think first, and then manage," says Taizoon Chinwalla, 46, former participant and a director at Motorola Inc.

Canada is an odd place for insights into the training of the capitalist elite, considering its statist bent, complete with high taxes and national health care. But Canadian educators have been wrestling with new ideas in management since some provinces stopped funding graduate degree programs in 1995. Making ends meet meant steep tuition hikes and struggles to retain faculty tempted by high salaries abroad. So they opened their doors to a wider pool of applicants, admitting more foreigners than ever. More important, they jettisoned the old approach of specializing in such fields as corporate finance or brand management and replaced it with a new emphasis on producing big-picture leaders. "Canadians are less formulaic about education," says Gerald Ross, dean at McGill Faculty of

Management. "We don't imitate what others do."

Back in 1995, the need to raise funds quickly was an effective spur to innovation. For Queen's School of Business, that meant leaving the herd. It refocused its full-time MBA program on students who specialize in science and technology. That let Queens offer more sophisticated classes and led grads to lucrative jobs. McGill offers an IMPM program in niche markets. It's already training execs in nonprofits and plans to target health profes-

sionals next. Who knows, Ross suggests, maybe priests, rabbis, and teachers could follow?

MBA TO GO. The programs are hitting the road, too. Queens invested \$10 million in its Videoconferencing Executive MBA program and is now Canada's most subscribed, enrolling about 370. Unlike traditional programs, which use less technology, Queens' is a digital affair: Only three weeks of the 20-month program are in person with professors. That has caught the alliance-hungry eye of Cornell University's B-school, which could spread the high-tech program to the U.S.

Aiming at underserved markets abroad, the schools have planted roots in Asia. McGill runs an MBA in Japan for 50 students and expects to offer another in China. University of Western Ontario's Ivey School of Business set up a campus suited with videoconferencing technology and harbor views in the Hong Kong Convention & Exhibition Center in 1998, making it among the first North American schools to open in Asia. Since then, it has followed the legendary Harvard case-study approach, producing 203 business cases on Asian companies. It has also sold 100,000 translated casebooks in China since 1997, sweetening the Ivey brand on the mainland.

The foreign programs pay off. Last year, Ivey generated \$975,000 in revenues from the Hong Kong programs, with customers such as Reebok International Ltd. and Mattel Inc., both with big Asian manufacturing operations. The money helps, since Canada's B-schools are all financially squeezed. Queens has an endowment of just \$17 million, for instance, vs., say, University of Michigan Business School's \$268 million. But if their innovations catch on, Canada's B-schools could start raking it in.

*By Mica D. Schneider
in Toronto*



Enlightened Education

After provincial governments slashed funding in the late 1990s, Canada's B-schools reinvented themselves. A few innovative programs:

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Program shuttles managers around the globe in a 16-month program; offers an MBA in Japan

Executive MBA via videoconferencing could expand to U.S.; a yearlong MBA is aimed at science and tech managers

New dean is bucking U.S. MBA traditions and making all courses interdisciplinary

Growing emphasis on Executive MBA program; set up a campus in Hong Kong's convention center

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ability to build the diverse, rich infrastructure that the next generation of e-business needs. This infrastructure is increasingly open and standards based, thus providing levels of integration and flexibility that will lead to more "intelligent" systems, permit companies to "e-source" much of the IT function they need, and generate a new level of e-business, dynamic e-business.



Louis Burns

Vice President, Architecture Group (former CIO), Intel Corporation

Reinventing eBusiness Infrastructure with Peer-to-Peer Technology

The Internet is driving rich media types and every e-corporation needs to ensure that they are in a position to take advantage of the rich content. The biggest issue facing the IT managers is the infrastructure cost. Mr. Burns will explain how P2P can enable more robust e-business applications including connecting and enabling the links of a

supply chain, distributing information, content, or software more effectively, and keeping information items on their original node with a central directory or a search capability. The success of pioneering P2P applications proves that decentralized computing has enormous appeal for millions of users and obvious benefits to Enterprise IT.

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TUESDAY, JUNE 12

General Session: Creating Competitive Advantage In Today's E-markets:

How-to Guide

10:30 am - 11:45 am

Leading business theorists and implementers agree: First, outsource every business function that doesn't directly contribute to your competitive advantage to a best-of-breed specialist. Then, pour all your resources into vigorously exploiting the core competencies that remain. Sounds sensible - but it's not easy! This session builds on the theorists' insights, offering realistic lessons learned from the pioneers. You'll get hard-won answers to critical questions like: how do you manage the transition to an outsourced model, and then manage your outsourcees to get their best? How do you retain the in-house expertise you really need? What happens if a key outsourcing relationship fails? And what have leaders discovered along the way about identifying their true core competencies?

Targeting Your REAL M-commerce, Mobile and Wireless Opportunities

1:30 pm - 2:30 pm

Wireless: it's proving to be more than this year's dot-com hysteria. This session focuses on today's real business successes in mobile commerce, identifying practical lessons or shaping your own m-commerce initiatives. Is the wild success of Japan's DoCoMo replicable elsewhere, or is it purely a phenomenon of Japanese culture and the limitations of Japanese wired Internet access? Will cell-phone micropayments or vending machines and parking meters work as well here as in Europe? Will U.S. consumers really shop from their cell phones? What lessons can be learned from initiatives such as WantGo and Kyocera? In short: What's really working, and where? What's most likely to work next, and when?

E-business Transformation: The Principles for Success

2:45 pm - 3:45 pm

Success in E-business requires not only new technologies, but also new practices and processes. Unlike new entrants, established market leaders cannot simply start with a blank slate as they design and implement their business strategy. However, established firms do have advantages. They can draw on assets, including data, infrastructure, customers, supplier relationships, which may be impossible for competitors to replicate. Managing E-business transformation requires an understanding of which business practices remain assets and which become liabilities in the Internet economy. In this session, Erik Brynjolfsson, co-director of MIT Center for

how to think critically about your goals for E-business change - and presents expert approaches for transitioning to E-business processes and systems. MIT Matrix of Change tool will be discussed in depth, with particular emphasis on how it has supported the E-business transformations of many leading companies.

Not Your Father's Internet: A Map of Today's Internet, and a Preview of Tomorrow's

4:00 pm - 5:00 pm

The Internet has changed dramatically, even in just the past year or two, and very few people have an up-to-date understanding of how it works today. Come to this session, and you'll be one of them. We'll present an up-to-the-minute "map" of the Internet - introducing the Internet's most important architectural changes, the radical shift towards a truly global Internet, and the role of today's leading players, from ICANN to Inktomi to Internet 2. You'll learn why - in spite of its dramatically increased complexity - the Internet is becoming easier to manage. Most important, you'll discover what it all means to you - and the key infrastructure decisions you'll need to make in the next twelve months.

WEDNESDAY, JUNE 13

General Session: The Key to Customer Retention: Building Trust

10:30 am - 11:45 am

For E-business initiatives to succeed, E-businesses must decrease their customer acquisition costs and increase their customer retention rates at the same time. The heart of the solution: world-class customer service and fulfillment that maximizes value throughout the entire customer lifecycle. In this practical, hands-on talk, you'll discover how companies are achieving quantifiable successes on both ends of the equation, by focusing on customers through the lens of trust. Along the way, you'll discover realistic, cost-effective solutions that address every aspect of trust: security, privacy, ease-of-use, loyalty, and community.

New Advances In Supply Chain and Partner Management

1:30 pm - 2:30 pm

To maximize the benefits of integrated supply chains and Internet-enabled partnerships, companies have discovered that implementing software and joining E-marketplaces are key elements of a total solution - but not the only elements. Straight from the frontlines, discover the latest lessons real practitioners have learned about supply chain and partner integration: technology integration, infrastructure platforms, culture, metrics, and more. You'll also preview the latest solutions and directions from the leaders in the marketplace: CommerceOne, Ariba, and many more.

Real-World Cases: Yesterday's Failures, Today's Opportunities

2:45 pm - 3:45 pm

In this session, we'll take stock of first-generation E-business initiatives - B2B, B2C, and enterprise. What worked? What didn't? What's finally working now? What still isn't? What lessons can your E-business initiatives leverage right now? In light of what's happened to date, what will tomorrow's E-business successes look like? Using real-world case studies, both positive and negative, we'll identify the proven patterns of

eBusiness, presents his breakthrough research findings on the underlying principles behind successful E-business transformations. No matter what your business, Brynjolfsson shows

E-business success - in technical infrastructure, business processes and models, customer relationships, and beyond.

The E-business Guide to Today's Capital Markets - and Tomorrow's

4:00 pm - 5:00 pm

Yes, the investment capital markets are far more challenging than they were a year ago, but the right ideas can still find capital - if they're backed by leaders with sufficient insight and expertise. The goal of this session is to teach you exactly what you must know now about strategic investment and funding - and preview the markets in 6 and 12 months, so you can dramatically enhance your odds of being funded whenever you're ready. We'll cover every alternative: strategic partnerships, corporate investors and venture organizations, mergers & acquisitions, "classic" venture capital, angels, even next-generation incubators.

THURSDAY, JUNE 14

E-marketplace Success: New Solutions for Buyers, Sellers, and Market Creators

10:30 am - 11:30 am

Failures get the publicity, but many E-marketplaces are flourishing amidst the cinders. Discover what makes them successful - and how you can leverage these differentiators as a buyer, seller, or market creator. We'll identify today's most successful E-marketplaces, market sectors where they're delivering the greatest value, and sophisticated new techniques for maximizing the benefits of participation. Sellers will discover new ways to exploit and provide content to public markets without sacrificing competitive advantage - and draw participants into private markets that optimize advantage. Buyers will discover new ways to reduce transaction processing costs, and benchmark existing pricing. Market creators will discover breakthrough approaches to adding value - including new advances in billing and financial settlement - all designed to ensure long-term viability and profitability.

E-business Human Resources: Managing Recruitment, Retention, and Retrenchment

1:30 pm - 2:30 pm

The #1 challenge for any E-business initiative is recruiting and retaining the right team - and even in an era of dot-com retrenchment, that's still brutally tough. In this up-to-the-minute session, senior managers and E-business human resources professionals review the realities of today's hiring marketplace, and present creative new solutions for today's dramatically changed E-business environments. And if you're retrenching, you'll discover invaluable techniques for motivating professionals and managing organizational endurance through layoffs and cost-cutting, as well as cost-effective compensation alternatives when your options are deep under water.

Choosing the Right E-services Providers

2:45 pm - 3:45 pm

For today's agile corporation, a new generation of E-services providers is making it possible to outsource more effectively than ever possible. Today's E-services encompass everything from professional services to infrastructure hosting, application services to next-generation development. Join leading outsourcing decision-makers and providers to learn exactly how to make the most of your new options. Drawing upon the experiences of companies that have already established extensive E-services relationships, we'll help you reassess what you should be outsourcing; set realistic goals; establish credible metrics; and learn new best practices for maximizing coordination and minimizing risk.

customers

The Heart of your E-business

More than ever, customers drive E-business: *demanding, tough customers*. In this track, we'll show you today's best solutions for wooing them, *winning* them, and *keeping* them. We'll show you sales techniques that move real product in real E-markets. How to use your existing knowledge to strengthen all your customer relationships. New ways to reach 12 million broadband Internet subscribers. CRM solutions that *work*. Privacy solutions that *work*. Customer service solutions that *work*. If it's about customers, if it works, it's here.

TUESDAY, JUNE 12

How to Really Sell in the Age of E-business

1:30 pm - 2:30 pm

Successful E-businesses know that "marketing" is no substitute for selling. And selling, as always, is hard work - involving shoe leather, sweat, and commitment. In this session, we'll bring together a panel of the E-business world's most effective sales professionals, offering an "on-the-ground" perspective on E-business salesmanship. What's different about E-business selling, and what isn't? How have customers' expectations changed in the past six months? How do you increase the confidence level of customers facing new uncertainties? What's the best way to use E-business technology to make selling more effective - and which hyped solutions are failing in real-world sales environments?

Marketing Risks and Opportunities: Personalization, Permission, and Privacy

2:45 pm - 3:45 pm

When properly implemented, permission-based, personalized relationship marketing can generate up to 10 times the response of other forms of marketing. It's worth the investment - and then some. But most E-business executives still struggle with building effective E-business marketing engines. Now, one of the world's leading practitioners offers practical advice with your toughest Web personalization and permission marketing issues. You'll discover how to sort through a cornucopia of approaches to Web personalization; mass-customize your marketing on and off the Web; integrate personalization into your entire technical and business infrastructure; transform privacy from a potential disaster to a competitive advantage; use permission marketing to build your brand; and much more.

Building More Effective B2B Customer Infrastructures

4:00 pm - 5:00 pm

Most of the profit in any B2B customer relationship comes from follow-on sales - so it's critical for enterprises to build strong ongoing relationships that capture those sales. Companies in diverse markets are discovering that their product knowledge offers a powerful opportunity to do just that. They're making customers "part of the enterprise," building powerful extranets that promote customer interaction in knowledge-rich, secure environments. This session offers strategies and tactics for building such an extranet architecture, as well as case studies from world-class aircraft and automotive manufacturers that have done it.

WEDNESDAY, JUNE 13

Real-World Workshop: Creating Rich Customer Experiences

1:30 pm - 2:30 pm

According to Nielsen Media Research, U.S. broadband connections have soared from 5 million to 12 million in only one year - and the pace of growth is accelerating. The emerging higher-speed Internet makes it possible to deliver rich media experiences that deepen your customer relationships and strengthen your brand. This hands-on workshop will show you how to do just that. You'll discover creative marketing techniques you haven't seen before; learn how to use rich media to provide new interactivity between customers and your enterprise; discover technical solutions for integrating rich media on your site and in your infrastructure; and identify the best ways to serve broadband subscribers without alienating everyone else.

Content Management: Who Pays, and for What?

2:45 pm - 3:45 pm

Content producers from arenas as diverse as newspapers, publishing, music, and Hollywood are struggling to invent E-business models that work. What's the future of Web-based content? What will be the role of today's recording and film industries? Will tomorrow's Napsters eventually destroy the music industry's \$15/CD business model, and then move on to movies? Or will the RIAA and its colleagues successfully stuff the genie back into the bottle? Will Bertelsmann and others find ways to protect their properties while taking advantage of emerging content distribution channels? Will monthly subscriptions work? Can digital content enterprises other new revenue sources - and if so, where?

After the Sale: Building Responsive, Effective Customer E-service

4:00 pm - 5:00 pm

E-business has only exacerbated your customers' need for "instant" service. But how do you build service systems and processes that will delight your online customers and keep them from clicking over to your competition? This PowerPanel of leading E-service experts and cutting-edge company practitioners will discuss a range of topics including: How should you choose the right technology solutions? Who are the "big" players in the E-service market? What are the best ways to use e-mail, text chat and live voice in E-service? Is the ASP (hosted) solutions model right for you? Should you outsource E-service? Don't miss this opportunity to bring your most pressing questions to our E-service panelists!

THURSDAY, JUNE 14

E-learning: Underpinnings for the Flexible Company

10:30 am - 11:30 am

"The Learning Organization" isn't just a buzzword, it's an absolute necessity. To keep your workforce energized, empowered, and ready for whatever comes their way, you'll need to leverage today's breakthrough E-learning solutions. "E-learning" covers a wide range of technologies and approaches, from knowledge management and just-in-time E-training to data mining, next-generation data analysis, and collaboration. In this session, you'll learn how to implement effective, accessible E-learning systems that really work - systems that invigorate all your business processes, from sales and marketing to finance and HR.

The Privacy Debate: What Do Customers and Businesses Really Want?

1:30 pm - 2:30 pm

Without trust and privacy, most customers simply won't build relationships with you. But guaranteeing privacy is not easy. You must articulate a privacy policy that still allows you to conduct profitable business, communicate that policy effectively, and implement it in hardware and software. In this session, a leading executive responsible for customer privacy shares new insights into every aspect of the E-business privacy issue. You'll learn how customers' expectations for privacy are changing in surprising ways; how to translate privacy policies into your strategy, planning, and technical infrastructure; and how to build privacy solutions that can evolve as the requirements of customers, marketers, and regulators change.

Tomorrow's Demand Chain: Integrating CRM and Customer Systems

2:45 pm - 3:45 pm

Getting closer to your customer. It's everyone's priority, but in too many organizations, CRM is foundering on the complexities of technical and organizational integration. A handful of companies are getting it right, and here's your chance to learn from them. In this session, we'll bring together executives whose CRM initiatives are delivering quantifiable benefits. They'll present proven solutions for: simplifying and streamlining the deployment of Siebel and competitive systems; ensuring that customers and salespeople each get what they really need from your CRM initiative; and for going beyond CRM to integrate all aspects of the demand chain, improving how you move every potential customer towards a closed sale.

execution

What it Really Takes to Get the Job Done

If you can't get the job done, nothing matters: not strategy, not marketing, not sales. This track brings together the top leading E-business implementers: people who are delivering real results, right now. You'll walk away with *actionable* techniques for integration, implementation, and every stage of the E-business lifecycle. You'll discover *specific* solutions for virtually every E-business system, from billing to wireless, enterprise application integration to security. And you'll get crucial decision-making guidance for the next generation of E-business technologies, from XML to Linux, rich media to...

TUESDAY, JUNE 12

Content Management: Harnessing Digital Assets for Competitive Advantage

1:30 pm - 2:30 pm

As businesses move B2B and customer-facing applications online, excellence in content management has become a major competitive advantage. A content management system separates content (generally unstructured data such as text, document, image, and video) from the physical confines of how it will be presented. In other words, the content flow can more easily become part of a larger e-business, supply chain, e-procurement, or other enterprise application, no matter is the graphical presentation platform. Especially with E-business, keeping all forms of content freshly updated, accurate, and personalized is essential. This session will help you assess your organization's content management status and identify the specific steps involved in putting your organization's content to work in gaining a competitive edge.

Development Tools and Techniques for Next-Gen Mobile and Wireless Applications

2:45 pm - 3:45 pm

To mobile-enable your company, you must first master the complex art of creating mobile applications. In this primer leading mobile application consultants cover every step of the mobile application development process, from requirement through design, testing through rollout, maintenance through upgrades. You'll get detailed, practical guidance on updating your tethered applications with mobile front-ends, leveraging existing business logic, application infrastructure, and design. You'll discover state-of-the-art solutions for creating time-to-market-based m-commerce applications; learn how to manage diverse end-user platforms and deploy across multiple wireless data networks; and discover new ways to prepare applications for tomorrow's higher-bandwidth networks and more powerful clients.

Securing Enterprise Infrastructures: Protecting You and Your Customer

4:00 pm - 5:00 pm

Network and security professionals are trying to accomplish a virtually impossible task: securing business traffic across an inherently insecure Internet. As more and more companies discover, firewalls are not the whole solution: you may need intrusion detection to catch the bad guys who make it across your perimeter. In this session, we'll begin with a practical security checklist for the enterprise: do's, don'ts, and key decision metrics. Then, we'll take a closer look at intrusion detection, helping you determine whether it's worth the investment, and showing you what's involved with deploying and managing it. Finally, you'll hear how several leading intrusion systems would respond to an actual intrusion.

WEDNESDAY, JUNE 13

XML Seminar: The Glue that Binds You to Your Customer

1:30 pm - 2:30 pm

XML. It's been heralded the new lingua franca of E-business: the tool of choice for integration of E-business systems among E-business and legacy systems. Now, an XML expert who's used it to create integrated enterprise E-business environments presents a detailed overview of what's involved including real-world do's and don'ts for integrating CRM, ERP, and other enterprise systems. You'll identify practical obstacles to interoperability; learn how to access XML data programmatically using DOM; and discover how to use XSL to transform XML documents and reflect business rules. You'll learn whether



OAP is ready for prime time, and how to choose amongst the many technologies that integrate with XML, from Sun's Servlets and JavaServer Pages to Microsoft's Active Server Pages. Finally, you'll review how XML stacks up against alternative approaches.

Preparing for Rich Media: Tools, Infrastructure, Architecture, and ROI

10:30 am - 11:15 am

As the broadband Internet becomes a reality, more companies are delivering rich media applications – and thousands of companies are preparing for the day when they will. In this session, we'll systematically review the technical issues involved. How can you project the impact of rich media applications on your existing network infrastructure? What are the short-term solutions for bottlenecks that may arise, and how can those solutions be integrated into a longer-term plan? Will your network need to be re-architected or merely retrofitted? What role will caching and other third-party solutions play? And how can you analyze ROI on the investments you'll need?

Information Infrastructure for Customer Intelligence

10:30 am - 5:00 pm

Despite all the hype and bluster associated with the emergence of e-commerce, the ultimate goal of customer-focused organizations is the same as it ever was: maximizing lifetime customer value. However, the "one-to-one" customer interaction for which most organizations strive is a massively complex objective that spans multiple inbound and outbound channels, application silos, data stores, and business processes. Furthermore, that objective often reveals corporate culture roadblocks in both the IT and business organizations that are equally more problematic than the technology challenges themselves. In this session, you'll learn about the business and technology trade-offs involved in creating proper information infrastructure for multichannel CRM (or "enterprise commerce management"), including the familiar "buy vs. build" quandary, new trends in data warehousing and real-time data aggregation, how to create business performance metrics based on customer satisfaction, and more.

THURSDAY, JUNE 14

AI: Binding Internal and External Systems

10:30 am - 11:30 am

In the emerging world of E-services and extended enterprises, information, transactions, and IT systems increasingly transcend the walls of individual corporations. Of course, actually employing inter-enterprise applications is an intensely complex task, fraught with risk. In this session, leading implementers will offer in-depth guidance based on their extensive experience. We'll help you set realistic goals, identify the technical, business and cultural obstacles to thorough cross-enterprise application integration; understand the advantages and limitations of currently available EIA tools; and walk you step-by-step through a real EIA project, pitfalls and all.

Peer-to-Peer: The Next Internet Paradigm, or Just the Next Fad?

10:30 am - 2:30 pm

You thought peer-to-peer went out with Windows for Workgroups – but it's back, *big time*. Some people claim that it's the future of the Internet – and applications such as Napster and SET@Home certainly prove its potential to scale! In this session, we'll review P2P from a business and technical perspective – both as a potential solution for the enterprise, and as a business model for emerging Internet companies. We'll review P2P applications (from privacy to resource sharing), market models and revenue sources; and architectural issues (how decentralized should the network be). We'll show you what's on the horizon, help you learn the lessons of pioneers such as Napster, and determine when and if P2P technology will offer value to you.

Linux as an E-business Platform: Advantages, Risks, Solutions

2:45 pm - 3:45 pm

Linux: it's open, virtually free, and increasingly powerful. But is it the right solution for your mission-critical E-business systems? In this session, we'll take a hard-nosed look at Linux' advantages, identify its key risk factors, and review your options for mitigating those risks. We'll show you where Linux may add the greatest value in your organization, and present the real-world experiences of pioneers who've deployed it in serious enterprise systems. Along the way, we'll cover key issues such as: Linux application development environments; staffing Linux environments; integrating Linux into your existing network and client infrastructures; and planning for the availability of new solutions developed via the open source model.

There's no substitute for the experience of real-world E-business implementers – especially when it comes to the "bet-your-company" applications that promise the greatest competitive advantage. Choose between 9 exclusive powerhouse case studies that illuminate the hard lessons pioneers have learned about E-business transformation. From wireless to CRM, storage to site scalability, here's your chance to learn from those who have gone before you – without taking the arrows!

TUESDAY, JUNE 12

Linux in the Mainstream

10:30 am - 11:15 am

Don't miss this case study featuring a first-hand glimpse of Linux in action! Come hear a leading customer tell all about its use of Linux – get a nuts-and-bolts account of how it implemented Linux, including the resources required, how Linux is key to its solution both from a development and production perspective, and how the company plans to leverage its Linux advantage going forward. Time will be allocated for a question and answer session with both the customer and an IBM representative on this compelling customer success story.

Knowing What Customers Will Do Next – Before They Know

11:30 am - 12:15 pm

CRM and eCRM systems are increasingly relying upon sophisticated predictive techniques to classify customers into highly granular segments based on their behavior to date, construct models projecting what they'll do next, and identify the most cost-effective marketing approaches to each micro-segment. In this case study, a leading edge implementer of personalized CRM shows how it works in practice – and helps you project the potential benefits. Discover how personalized CRM can be applied to rapidly changing markets and product sets; how to rapidly improve your results based on experience; and where to find help with the details – from the complex mathematics to the equally complex details of implementation and integration.

Covisint and Intel Corporation: Revolutionizing the Auto Manufacturing Supply Chain

1:30 pm - 2:15 pm

What does it take to form one vast marketplace where thousands of auto parts and equipment companies exchange information regarding forecasts, inventory, billing shipments and product design in real time? Intel, Microsoft, and Dell have joined forces with GM, Commerce One, Direct Sourcing Solutions, Inc., and the EMPowerment foundation to participate in the industry's b2B E-commerce initiatives. Covisint, a newly formed company representing a merger of General Motor's and Ford's independent automotive E-markets, will discuss how they are turning the auto-industry upside down. The attendee will learn how relationships with technology leaders such as Intel increased Covisint's opportunity to succeed in the new Internet economy.

Exponential Content Growth and Your Storage Architecture

2:45 pm - 3:30 pm

Rich media is going to dramatically alter the demands on the E-business storage architecture. Tomorrow's storage architecture must continue today's business transaction processing and be extended for rich media content creation, production and the user experience. Storage strategies and architectures must be developed to deal with exponential content growth that will result from including rich media for sales promotions, product demonstrations, customer service and training. In this session you will learn about storage architectures and discover what the requirements are for content creation, production and delivery. Attendees will walk away with vital information about the impact on transaction systems and storage.

WEDNESDAY, JUNE 13

The Realities of PKI Deployment – From Start to Finish

10:30 am - 11:15 am

Using X.509-based PKI systems, digital signatures, and encryption, extended enterprises can build remarkably secure infrastructures. But deploying PKI is exceptionally complex, especially when the goal is to interconnect multiple enterprises and wide communities of interest. In this case study, a leading-edge adopter reviews the challenges of making PKI work in the real world. You'll gain insight into issues ranging from establishing certification authorities to distributing certificates and ensuring their legal authority in international business environments. You'll also discover what it takes to make diverse PKI systems interoperable – and what key challenges still remain.

Global Energy Leader Teams with Asera™ for Next Generation Web Services

11:30 am - 12:15 pm

This case study will show how one of the world's largest global energy companies implemented Asera technology to successfully integrate 16 business units in the US and Europe in 90 days, providing a seamless portal for its global customers. The solution provides customers with a Web-based system to place orders, verify order status and obtain detailed product information, from anywhere, anytime. The session will discuss how the Asera platform and sell-side eCommerce applications enable customers to customize and leverage best-in-class Internet software, pay for what they use, and remain insulated from the cost and complexity of technology change.

Connecting Buyers and Sellers Ain't Enough: Building an E-Marketplace that Adds Value Everywhere

1:30 pm - 2:15 pm

For E-marketplaces to work, they'll have to add value far beyond simply connecting vendors and suppliers. In this case study, you'll discover how a leading-edge E-marketplace is gaining traction through a wide range of added-value services that simplify transactions for every participant, buyer and seller alike. Discover how a leader worked with its customers to identify opportunities to reduce transaction costs and shorten the supply chain – and how it is providing equally creative solutions for suppliers apprehensive about the potential of E-marketplaces to commoditize their offerings.

Wireless Financial Transactions – Lessons Learned (and Lessons Yet to Be Learned)

2:45 pm - 3:30 pm

The killer application for wireless is personal financial information. In this case study, you'll walk through the entire decision-making and deployment process as a major financial institution delivers wireless support for high-value customer transactions. Whether you're in financial services or not, you'll learn lessons directly relevant to your wireless strategy: lessons about coping with diverse end-user platforms, ensuring security in wireless environments, managing the challenges of custom wireless application development, maximizing usability, leveraging wireless gateways, insourcing vs. outsourcing, reducing time to market, projecting ROI, and much more.

THURSDAY, JUNE 14

Optimizing E-business Investments: How to Extract Value from E-business Initiatives While Avoiding the Mistakes of Others

10:30 am - 11:15 am

E-business initiatives can be paramount to the success of a competitive organization while failures can cripple a thriving enterprise. Many companies have made initial forays into E-business with limited success and seek better returns. Others have experienced dismal failures and are evaluating possible alternatives. E-business roadblocks result from a variety of issues including politics, communication problems, process issues, technology, and lack of organizational alignment. This session examines specific aspects of project success and analyzes the failed attempts of others for insight into best practices. Panelists will provide their firsthand knowledge of keys to effectively delivering value from E-business initiatives and provide their analysis in observing others who have failed. Attendees will understand what adjustments to make in implementing their E-business strategies or how to revitalize projects that have gone awry.

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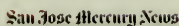
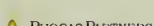
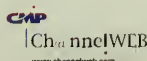
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- M. Wireless Internet Solutions

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- E. Business Unit Manager/Project Manager
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- I. Internet/Intranet/Extranet (Networking) Hardware and Software
- J. Web Servers and Related Technologies
- K. Front End Internet Access Technologies: PD's, Terminals, Browsers
- L. ASP/ISP/XSP Service
- M. Storage
- N. Wireless and Mobile Commerce Applications
- O. E-business Services and Integration

The Realist's Guide to **Integration & Innovation**

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LEBOW TURNS OVER A NEW LEAF

LeBow says Vector's no-nicotine puff will help millions quit

Miami financier Bennett S. LeBow has always had a wickedly irreverent streak: After a proposed takeover of Prime Computer Inc. fell through in 1989, a dejected LeBow staged a wake for the deal. Dressed in black tie, LeBow and his partner dined on steak and lobster while their 150 guests ate hot dogs and beer at a New York City restaurant. LeBow, who is Jewish, even brought in a rabbi to say a prayer for the dead deal. For party favors, LeBow handed out lucite blocks containing "Prime" and condoms. Since his 1986 acquisition of tiny cigarette manufacturer Liggett Group Inc. for \$140 million, LeBow has done his best to oil the tobacco industry's rty as well. A buyout specialist long known for his bottom-fishing, the 63-year-old CEO of Miami-based holding company Vector Group Ltd.—formerly Brooke Group Ltd.—has been adding other cigarette makers since he took ranks with them in the mid-1990s and agreed to settle lawsuits initiated by states seeking to recover the costs of caring for sick smokers. Believing Liggett would be wiped out if it lost in court, he struck a deal: In return for paying \$1 million in damages, LeBow admitted that nicotine is addictive and that smoking causes cancer, and turned over revealing industry documents. **JITTER.** In the past year he has testified on behalf of smokers in a multibillion-dollar class action against Big Tobacco. He is also given \$2.4 million to Cornell University's medical school for research on early detection of lung cancer.



MAVERICK: LeBow is counting on his new smokes to boost Vector's sales

Now, the self-described maverick says his company is developing a safer smoke that should help some of America's 50 million smokers quit. Later this year, LeBow, who dropped a two-to-three-pack-a-day cigarette habit 30 years ago, hopes to launch Omni, a cigarette that he says has lower levels of carcinogens. And he claims that by early next year, he can bring to market a nicotine-free cigarette, Omni Free, made with genetically altered tobacco. LeBow says safer cigarettes will boost his 1.5% share of the overall market. Once Vector surpasses 1.65% of market share, it will have to start making pay-



SAFETY FIRST? Mock-up pack

ments to states, but the new cigarettes would also cost more—about the same as premium brands. "We don't know how big the market is, but we know it's going to sell," says LeBow.

Even while he acknowledges the dangers of smoking, LeBow still makes a ton of money from the habit. Liggett, which sells such discount brands as Pyramid and Tourney and the premium label Eve, reported \$73 million in operating income, up 11% for 2000, on sales of \$539.1 million, up 34%. "It's a very good business," he says. Vector, with sales of

\$739.6 million, also has a controlling interest in New Valley Corp., which includes such real estate investments and brokerage Ladenburg, Thalmann & Co. With Vector's stock now trading around \$26 a share, LeBow's 40% stake is worth about \$300 million, or more than 20 times his original \$14 million investment.

STRUGGLE. LeBow's toughest test will be persuading smokers to switch to a "safer" cigarette. Rival tobacco companies have tried unsuccessfully to come up with palatable alternative

THE LEBOW FILE

BORN Dec. 20, 1937, Philadelphia

EDUCATION BS, electrical engineering, Drexel University, 1960

MOST NOTABLE DEAL The financier turned around

and sold Western Union in 1994

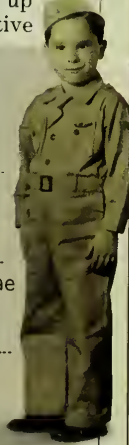
CURRENT JOB Chairman and CEO, Vector Group, parent company of cigarette maker Liggett Group

CAREER TURNING POINT In 1997, broke ranks with tobacco execs to admit that smoking is addictive and causes cancer

SMOKING HISTORY Quit in his mid-30s, after smoking two to three packs a day since he was 18

FAMILY Wife, Geraldine; two daughters

products. R.J. Reynolds Tobacco has been test-marketing Eclipse, a cigarette with lower levels of some carcinogens, since 1996, and it still hasn't figured out how to sell it nationally. Philip Morris Cos. pulled the plug on a no-nicotine cigarette a decade ago. LeBow claims Omni Free tastes like conventional cigarettes. But Vector can't back it with the marketing muscle of its much bigger rivals. And it can't advertise Omni and Omni Free as smoking-cessation devices. "Giv-



en their small size and small market share, it will be challenging for them to build a new cigarette brand," says Joel D. Luton, an analyst with APS Financial Corp. who personally owns a few hundred shares of Vector. Still, he believes the Omni brands could add \$150 million to yearly cash flow within three years.

Big Tobacco isn't LeBow's only hurdle. He struggled to enlist farmers to grow his genetically altered no-nicotine leaves. Many of them worried they would lose export sales if European buyers thought the new crops were mixed in with traditional leaf. But LeBow recently signed up some 600 Amish farmers in Pennsylvania, and now claims he has 80% to 90% of the 4,000 acres he needs. LeBow still faces opposition from smoking opponents, who insist there are no independent scientific studies to verify the new cigarettes are safer—or that they induce smokers to quit. "Nobody knows whether the product Mr. LeBow is introducing today will reduce the risk of disease," says Matthew L. Myers, president of the Campaign for Tobacco-Free Kids.

The son of a door-to-door insurance salesman in West Philadelphia, LeBow

LeBow's challenge is huge: His rivals have tried, and failed, to offer "safer" cigs

got the business bug early, selling men's clothing at a department store while in high school. LeBow says he made his first million after taking a jewelry business out of bankruptcy in the late 1970s. He built his reputation by targeting troubled companies, such as Prime Computer. But the deal that earned him the most attention was Western Union. In 1987, LeBow acquired the company for \$25 million. Although it had plunged into bankruptcy by the early 1990s, LeBow focused on Western Union's wire-transfer business and managed to sell it for a hefty \$1.2 billion. "When things are really bad, you know he's going to figure out a way to get out of it," says financier Carl Icahn, who teamed up with LeBow six years ago in a failed attempt to break up RJR Nabisco. "He's got a great survival instinct."

Whether LeBow can thrive as an innovator is another question. Persuading smokers to kick the habit through "safer" cigarettes will be his most challenging sale yet.

By Aixa M. Pascual
in Durham, N.C.

Science & Technology

COMMENTARY

By Paul Raeburn



BLOWING SMOKE OVER VENTILATION

This year is the 15th anniversary of an event that will not be celebrated by the tobacco industry: the publication of *The Health Consequences of Involuntary Smoking* by then-Surgeon General C. Everett Koop. The report solidly linked secondhand smoke to cancer and heart disease in nonsmokers, and included these words: "Separation of smokers and nonsmokers within the same airspace may reduce, but does not eliminate, exposure of nonsmokers to environmental tobacco smoke."

The report's publication was an ominous development for the tobacco industry. Smoking restrictions began appearing around the U.S. The rules, however, were effective in reducing nonsmokers' exposure to secondhand smoke. On Mar. 21, the Centers for Disease Control (CDC) released a study that found "a dramatic reduction in exposure of the U.S. population to environmental tobacco smoke" since 1991.

FRESH BREEZE. Despite this good news, the industry has struggled to shake off the restrictions. First, it ar-

gued that the science on secondhand smoke was suspect. Then it warned that smoking restrictions would put bars and restaurants out of business. Neither argument held up, nor did they slow the trend toward restricting or banning smoking in workplaces, public spaces, restaurants, and bars.

Now the industry thinks it has a strategy that can't fail. Its centerpiece? Ventilation. "Bringing in a lot of fresh air can help reduce the concentration of secondhand smoke and provide a more comfortable environment for everyone," says Brendan McCormick, manager of media relations for Philip Morris USA. "The comfort of the nonsmoker is what's at issue." Indeed, the company has been lobbying city councils and state legislatures to draft laws encouraging the use of ventilation as an alternative to smoking restrictions.

Public-health officials object to Philip Morris' new emphasis on "comfort." They say it obscures something much more important: the health of nonsmokers. According to the CDC in Atlanta, secondhand



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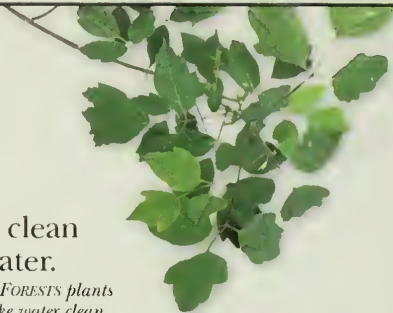
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Myth: Ventilation remedies secondhand smoke

smoke causes 62,000 heart-disease deaths and 3,000 deaths from lung cancer in the U.S. each year.

It's true that ventilation can clear up smoky haze and odors. Nevertheless, what the Surgeon General concluded in 1986 still holds true: The technology can't eliminate health dangers. Secondhand smoke is full of thousands of chemicals, many of which increase the risk of cancer, heart disease, and respiratory ailments. And air can't be judged by its smell, since many carcinogens are odorless and invisible. The best ventilation available today "cannot conceivably control secondhand smoke to acceptable levels of risk without tornado-like levels of airflow," declares James L. Repace, a consultant on secondhand-smoke hazards and former staff scientist at the Environmental Protection Agency.

The ventilation industry itself concedes the point. Its current published standards specify that air containing secondhand smoke cannot be considered acceptable, no matter how thoroughly it is ventilated. And even Philip Morris does not argue with these conclusions. "We don't in any way address the health effects of ventilation," says Thomas M. Ryan, manager of media programs for Philip Morris.

Meanwhile, the company continues to promote the technology. For example, it has created what it calls an Options program. It encourages owners of bars, restaurants, and bowling alleys to upgrade their ventilation systems so they can accommodate both smokers and nonsmokers—without either restricting smoking or confining smokers to a separate room.

GOTHAM MYSTERY. The latest battleground is New York City, where the City Council is considering a bill that would slightly tighten smoking restrictions in restaurants. Tucked inside is a proposal to create a task force to study ventilation as an alternative to separate smoking areas in restaurants. This dovetails nicely with Philip Morris' strategy: The company won't try to argue that ventilation keeps nonsmokers healthy. But the task force—with links to Philip Morris—will raise reasonable-sounding questions about whether it's really

necessary to ban or wall off smoking. And if New York goes on record supporting ventilation as an alternative to smoking restrictions, Philip Morris could use that to persuade other communities to do the same.

How the ventilation proposal got into the New York bill is a mystery. No one on the City Council takes credit for it, and a spokesman says it is unclear who inserted the language. "As far as I know, the language was put in there because there is some controversy" about ventilation, says the spokesman, Jordan Barowitz. Philip Morris' Ryan says he can't discuss details of the company's lobbying in New York City. But the company has been "actively involved in the legislative process" in many localities, he says.

Other localities have been down this same road. Cities include Anchorage, Alaska; Little Rock; and Mesa, Ariz., and states include Minnesota

and Washington. In Mesa in 1999, the industry nearly had its biggest victory. The City Council passed a bill allowing ventilation as an alternative to tough smoking restrictions. This was in response to a ventilation demonstration prepared by representatives from Chelsea Group, a consultancy in Itasca, Ill., that works closely with Philip Morris. The consultants were under instructions to make no health claims. But the demo succeeded on aesthetic grounds alone.

The victory, however, was short-lived. Local health advocates, alarmed by the ventilation legislation, protested vigorously that the health hazards remained. Four months later, the Mesa City Council reversed itself, reinstating regulations that required doors between smoke-free restaurants and adjoining bars where smoking is allowed.

STACKED DECK. Task forces to evaluate ventilation technology are the tobacco industry's latest play—but there is nothing novel about obfuscation. For decades, the industry has tried to create controversy around established facts. It produced consultants and "studies" arguing that smoking didn't cause cancer, that secondhand smoke wasn't dangerous, and that smoking restrictions could hobble businesses. This time around, with ventilation, it is encouraging the creation of task forces that are often required to include members from the hotel and restaurant industries, thus stacking the membership in favor of the tobacco industry.

A second hearing on the New York bill will probably be held this summer. In the meantime, the ventilation question may come up in other cities and towns, and it's bound to be controversial. In communities with active local health groups, such proposals are likely to be defeated. In communities where the health issues are not clearly pointed out, well-meaning city council members might find themselves relying solely on information supplied by Philip Morris and its consultants. That will be good news for Philip Morris—and bad news for public health.

Paul Raeburn covers science and the environment from New York.

THE HAZARDS OF SECONDHAND SMOKE

Nonsmokers face a variety of serious risks from exposure to other people's tobacco smoke. According to the Centers for Disease Control, secondhand smoke:

- ▶ Causes 3,000 deaths from lung cancer and 62,000 heart disease deaths in U.S. nonsmokers each year
- ▶ Causes serious respiratory problems in children, including increasing the frequency and severity of asthma attacks
- ▶ Increases the risk of sudden infant death syndrome and middle-ear infections in children
- ▶ Represents a common, severe public-health hazard that can be entirely prevented by adopting and enforcing tough antismoking regulations

Data: Centers for Disease Control



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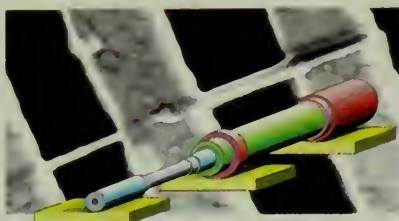
LET NO KICK OM... COTINE

ADDICTION TO NICOTINE is so intense that the American Psychiatric Assn. estimates that only 10% to 30% of those who resolve to quit make it past the first six months. But what if a simple vaccine could prevent a person from experiencing nicotine's pleasurable kick? Well, a pharmaceutical company based in Boca Raton, Fla., is testing this controversial idea by provoking an immune reaction to nicotine in the blood. Preliminary findings in rats have been so encouraging that the company plans to begin testing its vaccine, called NicVax, in humans later this year.

Under normal circumstances, the body would never mount an immune response against a small molecule such as nicotine. Company researchers overcame this hurdle by linking nicotine to a "carrier" protein that is easily recognized by the body's defense system. The goal: to unleash powerful antibodies that will scarf up circulating nicotine molecules before they can bind to receptors in the brain that trigger the pleasurable—and addictive—response.

The approach seems to work. When rats inoculated with NicVax were exposed to three cigarettes' worth of nicotine, the amount of nicotine that reaches their brains is reduced by 65%. It's enough to prevent the physical and behavioral responses normally sparked by nicotine, including skyrocketing blood pressure and increased motor activity.

Because it takes time to build up antibodies to the vaccine, NicVax won't immediately reduce cravings for nicotine. But in combination with current medications, it might purge the urge to puff.



HOW TO PACK A MIGHTY PUNCH ON A TINY CHIP

NANOTUBES—CYLINDERS of carbon roughly one-billionth of a meter in diameter—may one day serve as transistors on computer chips. Five hundred times smaller than today's transistors, they could be the basis for fast chips, but only if engineers can devise an inexpensive approach for densely packing them onto silicon wafers. Researchers at IBM think they have such a method.

It's a challenge because nanotubes naturally occur in two forms: semiconducting tubes and metallic ones. When nanotubes are deposited onto a silicon substrate,

the result is a dense tangle of both. To build devices, chipmakers need to eliminate the metallic tubes and manipulate only the semiconducting ones.

In the Apr. 27 issue of *Science*, a team from IBM Research led by senior scientist Phaedon Avouris describes one promising approach. First, the researchers disperse a tangle of nanotubes on silicon and fabricate electrodes on top of them. These electrodes are employed to switch off all the semiconducting tubes in the pile, so that they can't carry a current. Researchers then apply a voltage to selectively shatter the metallic tubes.

With this technique, researchers can also remove concentric layers of nanotubes that are rolled up inside one another (image). By sculpting such rolls of tubes, scientists can produce transistors with the properties they desire.

INNOVATIONS

■ Ultrasound, a mainstay of medical imaging, may soon have another use: removing toxic chemicals such as the gasoline-additive MTBE from groundwater. It's well known that sound waves of specific frequencies can be used to break apart harmful organic molecules. The challenge has been making the degradation process more efficient.

Civil engineer Inez Hua of Purdue University believes she may have partly solved this dilemma. In the Apr. 19 issue of *The Journal of Physical Chemistry A*, she demonstrates that it is possible to break down 1,4-dioxane, an MTBE-like molecule, into innocuous byproducts by blasting polluted water for two hours with sound waves at a frequency of 358 kilohertz.

■ In his 1999 book *The River: A Journey to the Source of HIV and AIDS*, journalist Edward Hooper posited that the modern-day AIDS epidemic arose when oral polio vaccine samples made from contaminated chimp cells were given to people in the Belgian Congo. The book sparked heated debates at scientific meetings as well as in Internet chat rooms. But new data should finally quell the furor.

Four independent studies, published in the Apr. 26 issue of *Nature* and the Apr. 27 issue of *Science*, categorically repudiate the link between the oral polio vaccine and the rise of AIDS. Using a sensitive laboratory technique called polymerase chain reaction to amplify DNA in more than 20 remaining samples of the vaccine, researchers at the different institutions were unable to find traces of either HIV-1, the strain that causes AIDS; SIV, the monkey version of HIV; or DNA indicating that chimp cells were used to prepare the vaccine.

LEARNING FROM THE BEES TO GET ZZZs

THERE MAY SOON BE HOPE FOR THE SLEEP-DEPRIVED OR jet-lagged, deduced from the mysterious habits of honeybees. In the Apr. 26 issue of *Nature*, entomologists at the University of Illinois at Urbana-Champaign report that honeybees automatically reset their internal body clocks in times of stress. Understanding exactly what happens at the cellular level could point the way to new therapies for human insomnia and other disorders.

In the typical hive, larvae are nursed round the clock by young bees, while older bees forage for food. Foraging requires a well-developed internal clock, because the bees depend on the sun to navigate toward pollen-containing flowers. The researchers observed that if the population of nurse bees suddenly plummets, forager bees immediately take over nursing responsibilities—and reset their internal clocks in the process.

The researchers don't know how the bees retune their body clocks. They believe a complicated network of genes—many of them shared by bees and humans—is probably involved.





THE ADMINISTRATION

MUZZLING 'KING TOMMY'

Is Tommy Thompson the real compassionate conservative?

During his 14 years as governor of Wisconsin, Tommy G. Thompson was known as "King Tommy." He oversaw every aspect of state policy, from overhauling welfare to negotiating leases on office buildings. Line-item veto power allowed him to

change budget numbers unilaterally.

As Health & Human Services Secretary, Thompson wields enormous influence over social policy. But he is no longer king. "When I was governor, everyone reported to me," he says. "Now, I have to report to OMB and the

HHS SECRETARY THOMPSON

The former governor concedes he has "already been in the doghouse"

White House, I have 535 bosses on Capitol Hill. It's a big change. Already, Thompson, 59, is getting a taste of what it's like to be outside the room where the big decisions

are made. On Apr. 9, for example, he hinted that the Administration would delay and ultimately change Clinton-era rules regulating the confidentiality of medical records. Three days later, President Bush announced that the guidelines would be implemented after all, despite fierce opposition from managed-care and pharmaceutical companies.

SMOKE ALARM. That's not the first time since Thompson came to Washington that he has been caught flat-footed. He is generally more moderate than the Prez and has deviated from the Administration line on topics ranging from Medicare funding to tobacco regulation. While snagging the nationally prominent Thompson for his Cabinet was a coup for Bush, the two ex-governors could be in for a rocky partnership. "He could show a pragmatic, compassionate side to the Administration, if they would let him," says Senator Russell D. Feingold (D-Wis.), who has known Thompson for nearly two decades.

But Thompson said at a break-out meeting with reporters recently that he has been told by top White House aides that his opinions "don't matter." On tobacco, which he thinks the federal government should regulate, Bush staffers have admonished him to keep his mouth shut. And though he has been an avid supporter of stem-cell research, Thompson recently signaled that the Administration may ultimately side with anti-abortionists seeking to prohibit federal funding for studies involving human embryos.

On other issues, though, Thompson continues to speak his mind. To red-

OFF MESSAGE

Thompson keeps wandering away from the Bush Administration line:

MEDICAL PRIVACY Thompson hinted at a delay in Clinton-era rules protecting the privacy of medical records; three days later, Bush said the guidelines would take effect on Apr. 14.



TOBACCO Thompson says he favors regulation; the White House, which has yet to state a position on the issue, chided Thompson for speaking before the President.



HEALTH PROGRAMS To reduce the number of uninsured, Thompson supports increased funding for the Children's Health Insurance Program, a Democratic approach; the Administration is pushing tax credits to encourage individuals to buy their own insurance.



WELFARE Thompson advocates maintaining current funding for welfare-to-work block grants when welfare reform comes up for reauthorization. That may pit him against the House GOP.

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the number of Americans without health insurance, Thompson favors the Democratic approach of expanding the Children's Health Insurance Program. The Administration wants to provide tax credits instead, so individuals can buy their own health insurance.

Thompson also broke ranks with the President over accounting for Medicare funding. When the White House suggested diverting some of the surplus in the Medicare trust fund to finance tax cuts and other spending, he testified against the idea before the House Ways & Means Committee. The next time a hearing on the subject rolled around, Thompson was absent. "I've already been in the doghouse," he acknowledges.

ACID TEST. That isn't to say Thompson has lost his clout. For example, he will play a pivotal role when the 1996 welfare-to-work act comes up for reauthorization next year. Welfare could be an acid test for the Administration: If the economy continues to stumble and layoffs rise, the durability of the welfare reform "miracle" could be severely tested.

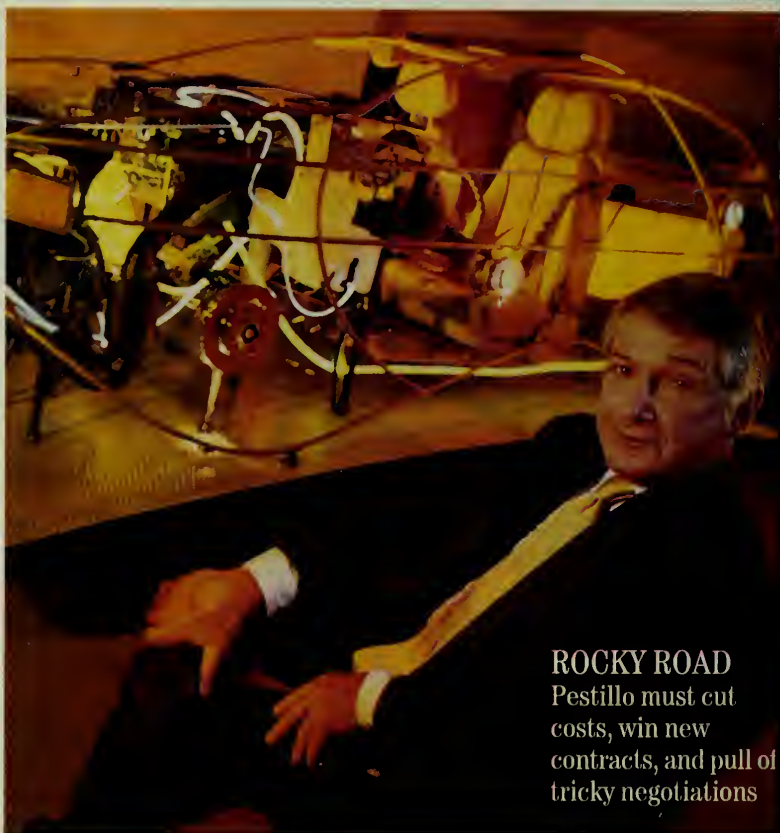
Revamping public assistance is Thompson's signature issue. Under his leadership, Wisconsin was one of the first states to institute work requirements, though it softened the blow by also providing child care, job training, and transportation. Wisconsin's welfare rolls plummeted, and Thompson's credibility on the issue could make him a powerful emissary to Republicans who are gunning for the block grants parceled out to the states. "He's going to help shape the consensus on welfare," says Donna E. Shalala, HHS Secretary under President Clinton.

Indeed, it was Thompson's record of innovation in social services that made him an obvious fit for HHS. Oddly enough, his first choice was Transportation Secretary. He has been chairman of Amtrak, the quasi-governmental passenger railroad company, since 1999. Thompson enjoys the job so much that he refuses to step down so Transportation Secretary Norman Y. Mineta can take his seat. "The President will make the final call," Thompson says. "And I am arguing my case vociferously."

With his progressive instincts and charismatic persona, Thompson will face many more substantive debates in the months ahead. "The question about the Bush Administration is: 'Will they hire smart people and let them do their jobs?'" asks University of Wisconsin political science professor Donald F. Kettl. "Or are they going to demand total loyalty?" Another question might be: In this right-of-center, stay-on-message Administration, how long can an outspoken, compassionate conservative last?

By Alexandra Starr in Washington

The Corporation



ROCKY ROAD
Pestillo must cut costs, win new contracts, and pull off tricky negotiations

SPIN-OFFS

VISTEON: THROWN INTO THE DEEP END

The Ford parts spin-off can't seem to catch a break

Visteon Corp., the automotive parts supplier lopped off from Ford Motor Co. last June, is like a 30-year-old slacker kicked out of his parents' house: It's burdened with excess baggage and has no experience living on its own.

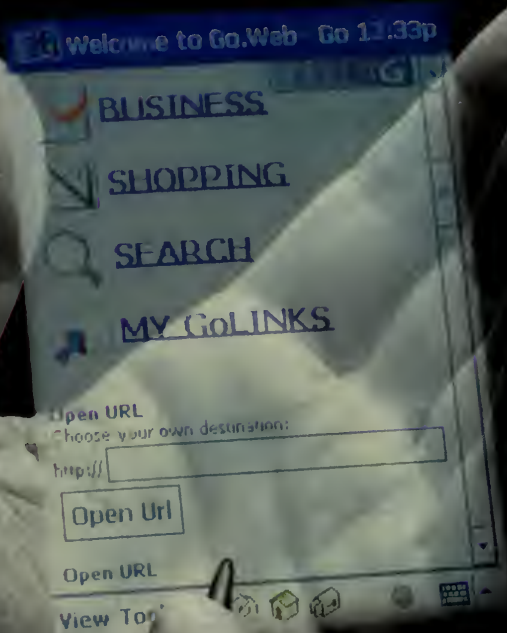
Growing up is hard enough, but Visteon, which makes everything from vehicle climate controls to navigation systems, hit the streets saddled with a grab bag of underperforming businesses and the priciest labor contracts in its field. And the timing was terrible. Just months after going public, the auto industry hit the skids.

Critics say Ford pushed Visteon out the door before the parts maker had a chance to fix its problems. Even so, the separation agreement required Visteon to hand over immediate 5% price cuts to Ford, its biggest customer. Then came the tire crisis at Bridgestone/Firestone Inc. Ford halted production of its popular Explorer SUV, costing Visteon, which supplied Explorer parts, an estimated \$16 to \$18 million in lost profit.

The result for Visteon was predictable—and indicative of the tough times ahead as it tries to lose a dependency of being just a Ford supplier. Visteon lost \$10 million in the fourth quarter of 2000, followed

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earnings of only \$31 million in the first quarter of 2001. That was better than analysts expected, and along with interest rate cuts, it helped the stock, which was battered late last year, climb from \$10 to a recent \$17. Still, first-quarter earnings were down 75% from the year-earlier period. For the full year, analysts project profits of only \$183 million, a 30% decline from last year. Says Visteon CEO Peter J. Pestillo: "I don't think any of us thought that things would seemingly get so bleak so soon."

TOUGH TASK. But even if Pestillo, a former Ford vice-chairman, broadens Visteon's customer base, cuts costs, and comes up with the flexible labor agreements needed to unload its weaker operations, it may be years before Visteon is a solid corporate performer. While Visteon has moved toward solving its problems, making its abrupt spin-off from Ford pay off will be no easy task.

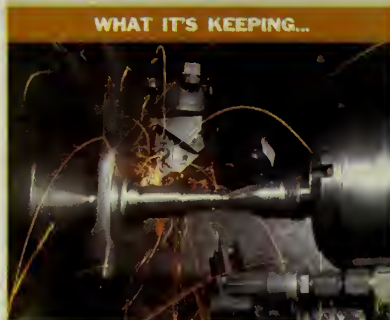
To start, the company is working to reduce its dependence on Ford by competing for business from other vehicle manufacturers. Before the spin-off, few auto companies were willing to share their product plans with a supplier that was owned by a competitor. That isn't the case now, so Visteon is broadening its customer base, especially overseas, selling to GM, Nissan, Fiat, and Volkswagen among others. At the end of 2000, about 16% of Visteon's sales were to non-Ford customers, up from 12% before the spin-off. Visteon wants to make that 25% within the next four years.

That would still leave Visteon largely dependent on Ford. And Ford, like the other auto makers, has become a hard bargainer. It will continue to squeeze Visteon for price cuts of at least 3.5% annually—or about \$600 million this year alone, by one estimate. Ford has already dictated the right to shop for lower-cost suppliers on future components, although it has given Visteon the right to match competitors' prices for three more years. For Visteon, then, the challenge is simple. Says Deutsche Bank analyst Kenneth Blaschke: "They have to prove over the next few years that they can reduce their cost structure much faster than they reduce their prices to Ford." So far, Visteon has cut 1,800 salaried jobs, or 2% of its total workforce. The company figures that the layoffs plus other restructuring moves will reduce costs by 15% a year.

Visteon is also looking to sell as much as \$2.5 billion worth of underperforming businesses. In glass, seating, steering systems, and air bags, it simply isn't big enough to make participation in

VISTEON: SEARCHING FOR THE RIGHT MIX

Ten months after its spin-off from Ford Motor, Visteon is still sorting out its product lines:



(\$17 billion sales)

- Climate control
- Interiors
- Electronics
- Vehicle chassis systems (above)



(\$2.5 billion sales)

- Glass (above)
- Steering systems
- Seat-sewing operations
- Air bag sensors

Data: Company reports

those markets worthwhile. But with the auto market in a slump, Visteon will be competing with some \$30 billion worth of other auto parts businesses already up for sale.

Some buyers have been scared away by expensive restrictions in Visteon's United Auto Workers labor contract. The agreement requires Visteon to match Ford's high pay scale for at least the next decade, even though most other suppliers pay 40% less than the Big Three. Already, one buyer, Pilkington PLC, walked away from a deal to buy

Visteon's \$750 million glass business because of those costs. When it failed to sell its glass business, Pestillo appealed to the UAW for help. In the past two months, he persuaded local union leaders to accept more flexible work rules at the affected plants in Nashville and Tulsa, making the glass business more viable.

Ford gave Visteon many of its problems in its haste to match the success of its 1999 spin-off of General Motors Corp. component maker Delphi Automotive Systems Corp. But GM gave Delphi five years to get its business in shape. "I used that time to streamline our portfolio and lay plans to separate quickly," says Delphi CEO J.T. Battenberg. Indeed, Delphi divested \$7 billion worth of unprofitable businesses and negotiated easier labor contracts in preparation for its independence. Ford did give Visteon nearly as much time.

As it was contemplating the divestiture, Ford was also grappling with the threat of a strike by the UAW, which feared jobs would be lost in a Visteon spin-off. That put Pestillo, then Ford's chief labor negotiator, on the hot seat. Ultimately, he agreed to the unusually generous contract to win union support for the deal. Although critics contend Visteon wasn't ready to go it alone, Ford wanted to push ahead. "There's no good or bad time to do it," says Pestillo. "I knew if we lingered, it wouldn't get any stronger." Ford spokesman Todd Nissen also defended the move: "It was a good decision then and remains a good decision now."

TALENT SCOUT. Visteon can take solace knowing other auto parts suppliers share its misery. Even Delphi is in the middle of another restructuring, looking to sell \$4.5 billion worth of businesses and cut 11,500 more jobs. Visteon is apt to have an even harder time coping than Delphi. "Visteon's management is at a disadvantage heading into rough waters because they haven't had time to fix the boat," says Merrill Lynch analyst John Casasa.

To stay afloat, Pestillo isn't just throwing excess baggage overboard. He also recently named Michael Johnston, a top executive at auto supplier Johnson Controls Inc., to be president and chief operating officer. One of Johnston's first moves was to create regional customer teams in a bid to win more non-Ford business. That's a start, but there's a lot of work ahead. Pestillo and team are going to turn this soft-around-the-edges slacker into a well-muscled athlete.

By Joann Muller in Detroit

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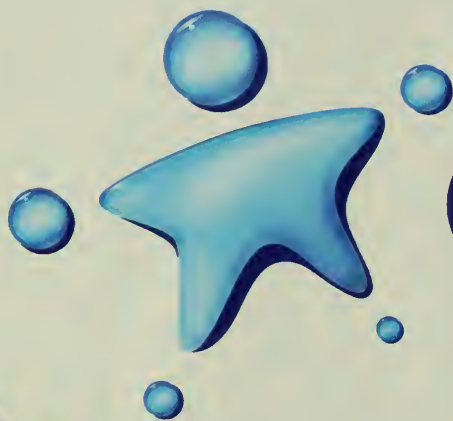
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PRODUCTION



NA

AN OIL GIANT STIRS

PetroChina is evolving into a modern profit machine

Forty years ago, in the bleak northern town of Daqing, tens of thousands of Chinese volunteers, full of revolutionary vigor, fought what the Communist Party hailed as the "battle for oil." The object: to secure the oil that China would need to develop a prosperous, self-sufficient socialist economy. To that end, workers hauled drilling equipment across the marshy ground, using nothing more than log rollers and sleds, and assembled huge oil rigs by hand. Party leaders have been paying tribute to the spirit of Daqing ever since, and a museum at the site displays worn copies of tracts by Mao Zedong that workers studied at night as they sat around campfires.

Today, Daqing symbolizes a very different kind of Chinese revolution. The 40,000 workers who now toil in these fields are part of the campaign to

turn their employer, PetroChina Co., into an efficient profit machine that will rank among the world's biggest petroleum companies. In just-released results for the year ended Dec. 31, PetroChina reported that earnings had more than doubled, to \$6.7 billion, on revenues of \$29.2 billion, blasting past previous earnings records for listed Chinese companies. In fact, PetroChina, with shares listed on both the New York and Hong Kong stock exchanges, already ranks as the world's fourth-biggest oil company based on output and proven reserves, though its market capitalization of \$35 billion is about one-eighth that of Exxon Mobil Corp.

While high oil prices are the biggest reason behind its strong financial performance, aggressive cost-cutting also has played a role. The Beijing-based corporation already is well into a West-

ern-style restructuring. Prior to last year's initial public offering, which raised \$2.9 billion, PetroChina hived off hundreds of noncore businesses, ranging from newspapers to hospitals, to its parent company, China National Petroleum Corp. It shed more than a million workers in the process. It is also pulling back from the refining business. Last year, PetroChina shuttered six refineries and 105 chemical facilities.

Now, PetroChina focuses on squeezing costs to get the most out of the lucrative business of oil and natural-gas production. From April until the end of last year, it laid off 38,000 workers, 8% of its workforce, at a cost of \$380 million in severance pay; 13,000 more will go this year. Chief Financial Officer Wang Guoliang promises to pare \$1.1 billion in annual spending by 2002. "Cost reduction will be an everlasting

These days, top management is preaching ideology from the little red book of shareholder value

theme for our company," vows Wang.

These days, top management is preaching ideology from the little red book of shareholder value. It urges workers to pay more attention to profits than to production volume. To boost motivation, PetroChina promises to extend

its path-breaking stock option plan from the 400 senior executives who currently participate to increasing numbers of its 442,000 remaining employees. Senior management has strengthened control over a company whose far-flung provincial bosses often ran their units like fiefdoms. That has allowed better use of capital. Debt has dropped sharply, and before new projects are approved, managers must show they can generate a 12% annual return on capital. BP Amoco PLC, which purchased a 2.2% stake in PetroChina for \$578 million, is helping it develop a chain of gas stations in the booming southern provinces. From the jazzy slide presentations that management puts on for investors down to the snappy new rectangular logo on its business cards, PetroChina is trying to become a modern company. It is headed by two men with three decades of experience as oil engineers: Chairman Ma Fucai and President Huang Yan. **STRIPPED AWAY.** The restructuring of PetroChina marks dramatic change in

a country where it was long unthinkable to reduce the size of an enterprise. PetroChina last year shut down 5.6 million tons of refining capacity, 5% of its total. That helped boost capacity utilization from 68% to 78%. A refinery and chemical factory in the gritty western city of Lanzhou, in Gansu province, are being merged. Layers of management are being stripped away, as are overlapping staff positions in marketing and production. PetroChina took an \$800 mil-

lion charge to rationalize its lube-oil operations in an effort to discard low-end products and to prevent different units from competing against each other. For the first time, company accountants know what's actually going on in everything from sales to inventory. Says

Chairman Ma: "Restructuring and long-term sustainable growth are our targets."

POLYMER PLANT: Stock options are a lively topic among workers



SHAPING UP PETROCHINA

STAFF CUTS Massively overstaffed, PetroChina cut 38,400 of its workforce last year, saving \$92 million. An additional 13,000 are to go this year.

COST SAVINGS PetroChina aims to cut \$1.1 billion in annual costs by 2002. It has already achieved 45% of its target, and last year took an \$800 million charge for closing six money-losing refineries, 105 chemical facilities, and many other business units.

PROFIT TARGETS All new projects must yield at least a 12% annual return on investment. Last year, return on capital jumped from 10% to 16% as PetroChina dumped unprofitable units and used IPO proceeds to slash debt. In 2000, its chemical businesses were profitable for the first time.

BETTER EFFICIENCY By weeding out weak facilities, capacity utilization for refineries jumped from 68% in 1999 to 78% in 2000.

Data: PetroChina, BusinessWeek

The message that life has changed has certainly filtered down to Daqing. Conversations with oil workers uncovered a decidedly uncommunist interest in stock options and how they work in the West. Wang Qimin, one of the revolutionary pioneers who helped build Daqing with little more than enthusiasm and muscle power, used to live in a makeshift hut during bitter winters when temperatures dropped below zero. Now, he is a well-paid top manager at

Daqing who helps oversee research trying to wring dwindling reserves of one of the world's longest-product oil fields. "Since being listed, we've had much more pressure from our investors to keep our production high," Wang, 63.

For all the progress, it will still be a while before PetroChina wins over many skeptics. To attract investors, PetroChina must pay a much hi-

dividend on its shares than Western companies. Foreign shareholders have been burned time and again by Chinese companies that talk convincingly about transparency and Western business practices but then ruin their balance sheets with reckless investments or by putting political priorities over investors' interests. If PetroChina can "cut the fat" on its cost-cutting plan," says Goldman Sachs & Co. analyst D. Bernard. "This is a year capital discipline will be tested."

The biggest test will come with a 2,600-mile natural gas pipeline PetroChina is building from the Tarim Basin in western China to Shanghai. Many analysts believe the \$5.2 billion pipeline is likely to yield a return close to the 12% return on capital Ma promises for new projects. But the government, which still owns 90% of PetroChina's shares, views it as a priority project because gas is a cleaner fuel than oil. And Chair-

man Ma is enthusiastic: "Natural gas will be our new driver of growth," he says.

If the pipeline turns out to be a money drain, it will only confirm that China's new corporate giants aren't ready for the global stage. But if Ma can turn the project into a big source of profits, he could well set a standard that shows the world that the Chinese market has arrived.

By Mark L. Clifford in Daqing



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COMMENTARY

By Pete Engardio and Michael Shari

THE IMF SHOULD QUIT PLAYING POLITICS

Ever since the 1997 Asian meltdown, officials from global lending agencies have been locked in two kinds of rituals. One is the periodic meeting in Jakarta, where a team from the International Monetary Fund (IMF) assesses the Indonesian government's sorry failure to fulfill its many promises of economic reform in return for billions in aid. The most recent encounter ended on Apr. 24, with the frustrated IMF refusing to release a \$400 million installment of its current \$5 billion loan package.

The other ritual is getting under way in Washington. It is the twice-annual meeting of the IMF, where delegates ponder ways to fix the shaky global financial system. Atop the agenda: how to rein in the IMF's propensity to heap complicated conditions upon nations that need its help—and respond to critics who say it should stop micromanaging entire economies.

HARSH DEMANDS. The IMF now admits it overreached in the 1990s, when it greatly expanded its role as a driver of sweeping structural overhauls of countries. Under new Managing Director Horst Köhler, and pushed by the Bush Administration, the IMF board has agreed it must reduce the number of conditions, mainly to those directly related to restoring financial stability. "There's a general consensus we need to be more selective and to focus on things that are essential," says Timothy D. Lane, chief of the IMF's policy division.

That will be some challenge. How will the IMF decide when privatizing a company, or cutting a food subsidy, or shelving import protection for a favored industry is vital to resolving a fiscal or monetary crisis? And when is this meddling? One answer: The fund usually crosses the line when it pushes the commercial and political agendas of Western donors or of other interest groups.

Indonesia is a case where the IMF

got way too involved. It started with the bailout of January, 1998. To be sure, the IMF had to make some harsh demands: Otherwise, its funds would have been used to bail out businesses of the Suharto family and its cronies—or siphoned offshore. But many of the 100-plus conditions it imposed clearly were designed to destroy Suharto's power base and to open financial and other industries to outsiders. Political and economic con-

seized from failed companies and banks, among other things.

As the IMF's frustration grew, investor confidence collapsed. Now, political strife and a slowing economy have sent the rupiah reeling, and Jakarta's budget deficit has shot past IMF targets. In December, the Fund suspended its loans after just one \$400 million installment. Its latest refusal to release funds could seal Wahid's political demise.

Jakarta must shoulder blame for not fixing its financial system. But by tying payments to too many complex reforms that must be executed in unison, "the IMF set itself up for repeated failure," says Gregory B. Fager, Asia director at Washington's Institute of International Finance Inc. What's more, each time the IMF delays a loan installment, it unleashes a huge ripple effect as other agencies withhold aid and investors recoil. And it's not even clear Jakarta needs IMF cash: It has \$29 billion in foreign reserves.

The IMF should not return to Jakarta until there is a government truly committed to reform. Even then it should wait until Indonesia is facing another meltdown.

Then, the question will be whether the Fund really can restrain its own impulses—and outside pressures—when imposing conditions. We'll see. In its new programs, the IMF is pushing Argentina to open its health-care and pension systems to outsiders, and spells out how Turkey must cut farm subsidies and privatize industries. Great for business. But hardly evidence of a minimalist IMF.

Engardio writes on the global economy; Shari covers Indonesia from Singapore.

MISTAKE? In Indonesia, many reforms the fund tried to impose proved impossible to implement



POVERTY: Indonesia's economy is still a disaster

vulsions resulted, and many reforms proved impossible to implement given Indonesia's weak institutions.

The IMF could have left in late 1999, when it lent Indonesia the last of its pledged \$11.5 billion. The economy was still wobbly, but was out of danger. And a new democratic government, headed by Abdurrahman Wahid, was in control. But in April, 2000, the fund unveiled a new \$5 billion loan program to help the transition and prod further reform. These good intentions went awry. Wahid's administration turned out to be a huge disappointment. Lacking both political clout and will, it hasn't lived up to pledges to slash fuel subsidies, oust disgraced central bank leaders, and divest some \$47 billion in assets

BusinessWeek online

For more on Indonesia and the IMF go to the Apr. 25 Daily Briefing at www.businessweek.com.



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SWEDEN

IN NEED OF A RECHARGE

Can Ericsson's Hellström reverse its fading fortunes?

Kurt Hellström looks as if he hasn't been sleeping very well. His suit collar is turned up, and his temper is brittle. "I have explained this so many times," grumbles the CEO of Swedish telecom giant Ericsson when asked the reason for his company's declining profit margins.

The last few weeks have been brutal for the 57-year-old Hellström, who became CEO in the summer of 1999. The global tech crunch has slammed Sweden's largest company, sending shockwaves through the country. The company expects the world market for its key mobile networks business to grow at 5% to 15% this year compared with 25% last year. Sales in the mobile-phone unit fell 52% in the first quarter.

Hellström has little choice but to embark on a program of cost-cutting that will bite deeply into the Swedish workforce. All told, Ericsson is shedding 22,000 of its 107,000 staff in an effort to save close to \$4 billion. That has brought yowls of protest and demands for Hellström's ouster in Sweden.

So Hellström was happy on Apr. 24, when he got to announce something more cheery. Ericsson is to join forces with Japan's Sony Corp. in the mobile-handset business. The two companies plan to pool marketing and development of future handsets in a company to be headquartered in London. The move will bring Ericsson a well-heeled partner. And it will allow Sony to apply its marketing and design savvy to Ericsson products, which are well engineered but panned as ugly.

Ericsson is betting that the Sony deal will turn into a consumer-electronics home run. It's not at all clear, though, that the two companies can quickly develop a killer brand in mobile like Sony's Walkman family of portable audio gear or its PlayStation computer games. And Ericsson's existing handset division is a disaster zone. It lost \$2.4 billion



SHRINKING: Slower growth is prompting Hellström to shed 20% of his staff

last year and \$570 million in the first quarter of 2001. Hellström says he's confident that cutting the handset workforce of 16,800 to fewer than 5,000 and outsourcing manufacturing to Flextronics International Ltd. will make the business profitable by the fourth quarter, whether or not Sony is on board.

Others are not so sure. Douglas Smith, analyst at Credit Suisse First Boston in London, projects red ink through the first quarter of 2002. He estimates that Ericsson will report an operating loss of \$1.4 billion on sales of \$26 billion for 2001, compared with a profit of \$3.1 billion on sales of \$27 billion in 2000. Cash outflow was more than \$2 billion for the first quarter, cutting cash on hand to around \$2 billion. "The thing about negative cash flow is that it can't go on forever," says Smith.

Handsets aren't the only problem. Ericsson is starting to see its margins slip in the vital network equipment business, which earned the company about \$3.3 billion last year on \$19 billion in sales. In the first quarter, those mar-

gins were just 4%, compared with a bust 14% a year earlier. Nokia Co. meanwhile, boosted margins to 11%. The slowdown in the U.S., Ericsson's biggest market, was one problem, addition, debt-strapped phone companies were using Ericsson as a de facto credit agency by delaying payments. **NOT A BANK.** Nokia may well try to start a march on Ericsson in the emerging market for third generation mobile equipment, which will offer consumers high-speed access to the wireless Internet. Nokia could grab share in the new networks by discounting and providing finance to its phone company customers. Ericsson has about \$2 billion in outstanding loans to customers, says Hellström, and going forward it will take a "cautious" approach to lending. He condemns what he calls a more aggressive approach by Nokia, which has \$3.8 billion in outstanding loans to customers. The bulk of the loans, \$2.7 billion, were repaid this year. There is a long way to go, however, before Nokia, which has 12% of the mobile systems market

this year, catches Ericsson, which had 32%. Mats Dahlin, CEO of Ericsson's mobile systems unit, says Ericsson is a subcontractor on 27 of the 47 deals announced so far.

It's too early to count Hellström out. He's a determined guy who is well respected inside the company. Ericsson's two key owners, the Wallenberg family and the Handelsbanken group, will be reluctant to sack him because he would be the third change of CEO in about three years. The company, after all, has been rocked by a series of unexpected shocks: It doesn't need more boardroom turmoil. It needs a rebound more than anything else.

By Stanley Reed in Stockholm, with bureau report

WHAT AILS ERICSSON

TERMINALS The mobile-handset business is losing market share and racking up losses in the range of \$500 million per quarter. The joint-venture deal with Sony won't be a panacea.

NETWORK EQUIPMENT Ericsson leads in mobile systems, but its margins are declining, and its market share is at risk.

NEGATIVE CASH FLOW The company is bleeding cash and running low on funds. It's not clear where it can raise new money.

DEADLOCKED OWNERSHIP Two Swedish shareholders, the Wallenbergs and Handelsbanken, control the company through A shares. This makes decision-making and bringing in strong management difficult.



NETWORKS: Mobile leader

Data: BusinessWeek



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FOX'S MISTAKE,
MEMBERS OF
THE PARTY SAY,
IS TO ASSUME
THAT THEY
WILL VOTE
WITH HIM IN
CONGRESS



MEXICO

SO FAR, FOX CAN'T RALLY HIS OWN TROOPS

The PAN may help kill a crucial tax-reform program

Frustrated by legislative gridlock over his controversial tax reform proposal, Mexican President Vicente Fox recently tried a new lobbying ploy: inviting congresspeople from the National Action Party (PAN) to a private screening of the movie *13 Days*, about President John F. Kennedy's handling of the Cuban missile crisis. The worm-munching politicians were treated to a not-so-subtle message: Presidents faced with big challenges in their first months in office must act boldly, of course, unilaterally.

The encounter was designed to galvanize support among PAN legislators. When sweeping tax reform, it didn't work. Hours later, on Apr. 17, Congress shelved the project and now may not pick it up again until September. That's a serious blow for Fox, who needs to start tax collection to finance his plans to expand education, health care, and employment. Postponing tax reform also could threaten other key initiatives, such as allowing private participation in the investment-starved electricity sector. "Fox's biggest enemy appears to be the PAN," says political analyst Denise Dresser of Mexico's Autonomous Technological Institute.

That comes as little surprise to many Mexicans. Fox is a straight-talking

politician who likes to take his message directly to the people via television and radio—usually without consulting the typically cautious PAN leadership. That's how he won last year's election, and that's apparently how he intends to govern. Yet Fox could be making a big mistake by failing to cement his PAN loyalties early on in his six-year term.

Of course, the PAN shares some of the blame for the tension. PANistas are miffed that the President went outside the party to fill many Cabinet posts. They also grumble that Fox, who joined the PAN in 1988, is a relative newcomer whose political philosophy doesn't match the party's. A key example: While Fox

boldly welcomed the Zapatista guerrillas on their recent visit to Mexico City, the PAN boycotted a congressional session with the masked rebels.

Still, Fox doesn't appear to realize that Mexico's democratic revolution has reached the Congress, which under more than seven decades of rule by the Institutional Revolutionary Party (PRI) served merely as a rubber stamp for Presidents. The PAN controls just 207 of the 500 seats in the lower house of Congress, and Fox assumes the party will vote with him as a bloc. "Fox doesn't seem to understand that while we support him in principle, we don't support him unconditionally," says PAN Congressman Fernando Martínez Cué.

What's more, Fox is not doing enough to reach out to opposition parties. PRI Congressman Jorge Chávez Presa complains that Fox reneged on a promise to send key Cabinet officials to Congress to discuss the tax initiative. "Neither the Finance Secretary nor any other top official has met with the Finance Committee," he says.

FIRESTORM. The irony is that most Mexicans believe tax reform is essential. The government collects only 11% of gross domestic product in taxes, one of the lowest rates in Latin America. Loopholes and exemptions granted over the years must be eliminated and new revenue found to reduce the government's dependence on oil revenues.

But Fox's proposal to raise \$14 billion largely by charging a 15% value-added tax (VAT) on food and medicine has sparked a political firestorm. The PAN, traditionally backed by the middle class and small business, worries about alienating poor and working-class voters who cast their lot with the party for the first time last year in hopes that Fox would improve their lives. "Fox doesn't seem to be worried about the political cost to his party," complains Martínez.

If Congress delays a vote on the tax legislation until September, it would be a real setback for Fox's ambitious reform agenda. To prevent that, he will have to show the PAN and other parties in Congress that he is willing to strike a compromise on the most controversial items in the package, such as the VAT. In short, Fox will have to prove himself a far better lobbyist than he has so far. And that will take much more than private movie screenings.

By Geri Smith in Mexico City

THE RIFT BETWEEN FOX AND THE PAN

IDEOLOGY Fox supports some left-leaning ideas such as expanded rights for Mexico's Indians and government-led industrial policy. The PAN prefers to focus on its probusiness agenda.

POLITICAL STYLE Fox tends to take his message directly to the Mexican people via radio and TV, making the PAN feel he is bypassing them.

INFLUENCE Fox named few prominent PANistas to his Cabinet, giving them little opportunity to craft government policy.

Data: BusinessWeek

COMMENTARY

By Paul Raeburn

THIS CLEAN OIL DEAL IS ALREADY TAINTED

In October, ground was broken on an oil project that promised to change the way investments are made in the developing world. Exxon-Mobil Corp., the lead investor in a \$3.7 billion effort to extract a billion barrels of oil from southern Chad, asked the World Bank to join the project as a lender because it wanted some political cover. The oil will be extracted in Chad and sent by pipeline across Cameroon to the sea. Both countries are ruled by authoritarian leaders, and ExxonMobil didn't trust either of them. The World Bank could prod both to honor their agreements or face the loss of international aid.

In return, the bank had demands of its own. It wanted ExxonMobil to help guarantee two things: first, that the project would spare the environment and protect the rights of the people of Chad; second, that Chad's government would distribute its oil wealth fairly among its people, rather than let it fall into the hands of its authoritarian ruler, President Idriss Deby.

FAMILIAR TALE. This marriage of convenience between the World Bank and Big Oil was seen as a new model for international development: It would rewrite the all-too-common script in which global projects that pledge to create wealth in developing countries just enrich an entrenched, undemocratic elite. Sadly, though, the project has failed its first test. And the failure raises disturbing questions about whether such projects can be done in a fair and responsible way.

About \$4.5 million of the first payment to Chad—a \$25 million signing bonus marking the project's groundbreaking—was secretly spent on

weapons, violating agreements with the bank and its sister agency, the International Monetary Fund. The arms purchase bolstered the arguments of many Western environmental and human rights groups, which opposed ExxonMobil's experiment on the grounds that Chad was unlikely to reverse its dismal human rights record.

Officials of the bank and the IMF

were put on hold, as were other support programs. "It was a major disappointment," says an IMF official. "The first time they got oil money, they did not spend it as they promised. It was a bad sign for the future."

ExxonMobil, meanwhile, continues to move forward. Chad's action "has not made any change in our plans for the project," says Tom Cirigliano, a

company spokesman. "We're still encouraged that the project will benefit the people of Chad."

There is cause for hope, because the World Bank reacted swiftly. "If there was any doubt that the world would be looking at what Chad would be doing, [it] was dispelled," says Roberto Calderisi, the World Bank's country director for Chad and Cameroon.

Chad already seems to be responding to the pressure. It has agreed to freeze the rest of the \$25 mil-



DEBY

Will Chad's authoritarian President distribute oil wealth fairly among the people?

were incensed at Chad's betrayal. Chad argued it needed the money for its battle with rebel forces in the north, but the bank rejects that argument—particularly because the money was spent without approval by Chad's Parliament. The bank says the money was supposed to help the desperately poor citizens of Chad, where the per capita income is about \$230 per year. By law, the oil revenues are to be used for education, health, and social service programs, with some of the money aimed specifically at rural development in the oil-producing region.

The bank and IMF suspended Chad from a program to help developing countries erase foreign debt. That cost Chad \$12 million to \$15 million in debt relief, says Mary Barton-Dock, the World Bank's representative in Chad. Some \$30 million in loans to Chad

lion payment until it sets up a parliamentary committee to monitor the pacts. "I feel we have made a breakthrough," says Pirooska Nagy, IMF's Chad mission chief in Washington.

The pipeline project will succeed only if Western countries and the oil companies—ExxonMobil and partner Chevron and Petronas, Malaysia's national petroleum corporation—make sure Chad honors its agreements. Chad's 8 million people are among the poorest on earth; if the oil project fails to deliver prosperity, they have few alternatives. The Chad pipeline could yet prove a turning point in Africa's story—or turn into a sad symbol of globalization's failed promise.

Senior Writer Raeburn traveled to Africa last year to report on the Chad-Cameroon project.

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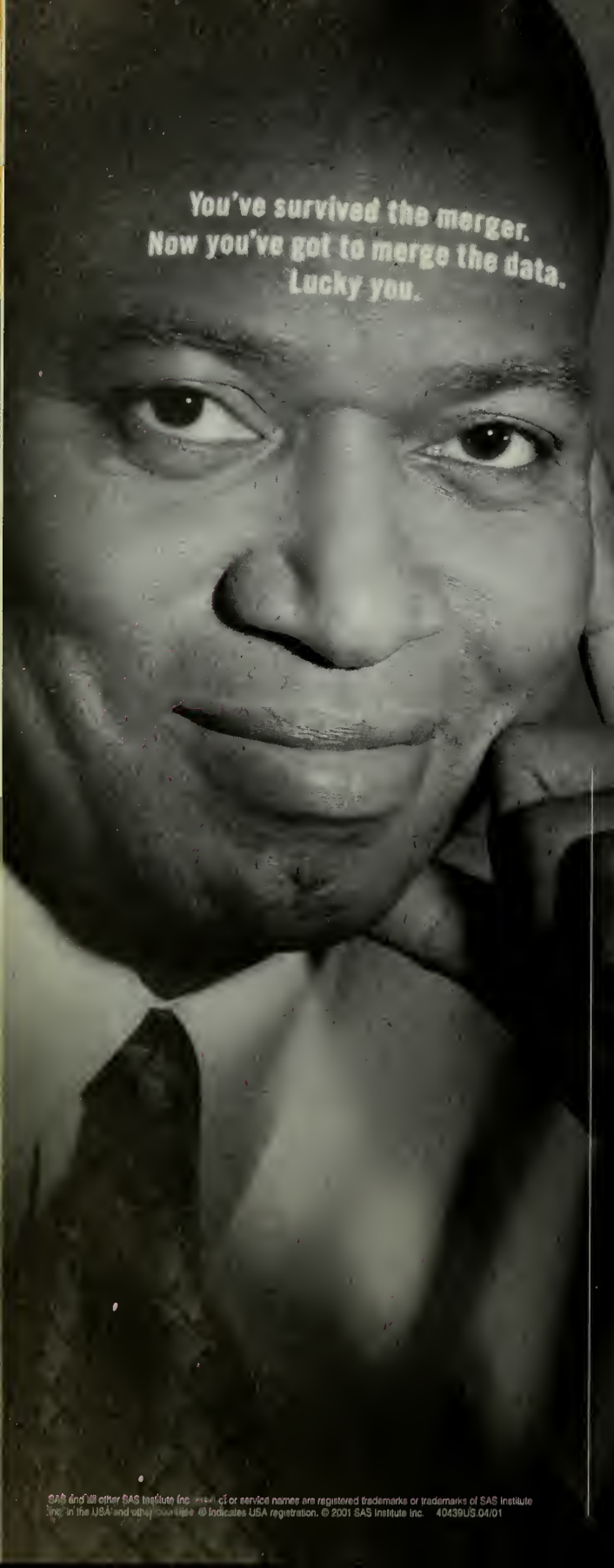
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ED BY ROSE BRADY

ROGUE STATES: WHY WASHINGTON MAY EASE SANCTIONS

ould the U.S. overhaul or even lift economic sanctions on rogue states such as Iran, Libya, and Iraq? A major battle will take place in Washington in the coming months over just this issue.

The fight pits powerful interests such as the pro-Israeli and the U.S. oil industry against each other. And it is to preoccupy the Bush Administration and Congress. The Administration is currently reviewing both U.S. energy and its policy on sanctions. Congress is expected to this summer on whether to renew the 10-year-old Iran-Libya Sanctions Act, which penalizes U.S. and foreign companies that invest in the two countries' energy sectors. The act expires on Aug. 5. Meanwhile, because of U.S. support, the U.N. is likely to revise its sanctions policy toward Iraq.

BETS ARE OFF. The issue poses a dilemma for the Bush Administration. Vice-President Dick Cheney, former CEO of oil equipment giant Halliburton Co., has long considered sanctions policy ineffective. Richard N. Armitage, recently appointed chief of the policy planning office at the State Dept., has also called for gradually easing sanctions on Iran in exchange for better behavior.

But any Administration or congressional decision on sanctions will be tightly bound with the politics of the targeted countries. Iran is the immediate problem. Presidential elections are scheduled there for June 8. President Mohammad Khatami, who has vowed to introduce reforms in the Islamic Republic, has not announced his candidacy. If he runs and loses, all bets are off. But if he runs, wins, and strengthens his position, the U.S. would be in a better position to ease sanctions—especially if Khatami makes a conciliatory gesture such as renouncing terrorism. The American Israel Public Affairs Committee, a Washington-based lobby, would do its best to block such a shift

in policy before a clear change in Iran's conduct, however.

Libya and Iraq are also troublesome. Tripoli has declined to pay damages for the infamous Pan Am 103 bombing, even though a Libyan was convicted for the incident. Saddam Hussein refuses to admit U.N. weapons inspectors to Iraq.

Even so, pressure from business is intensifying. "American farmers, workers, and companies have sacrificed without any progress toward U.S. foreign policy objectives," wrote Donald A. Deline, Halliburton's director of government affairs, to Senate Majority Leader Trent Lott (R-Miss.) on Apr. 18.

The reason business argues for an overhaul: massive leakage in the sanctions regime. In March, for example, Japan's state-owned aid bank ponied up 85% of the financing for a \$3 billion oil deal with Iran, a move aimed at paving the way for rights to develop part of the country's Azadegan oil field. South Korea wants to bid on \$5.5 billion in energy construction projects in Iran.

Although a review of sanctions policy is under way, Administration officials are reluctant to discuss how they plan to square their goals on energy and foreign policy. One way may be to move from broad prohibitions on trade to narrower curbs on items for building weapons of mass destruction such as nuclear technology. Secretary of State Colin L. Powell has proposed

such "smart sanctions" for Iraq. Former National Security Adviser Robert C. McFarlane has advised the Administration that such an approach could also work for Iran and Libya. "I'm optimistic the sanctions regime will be changed," he says.

Signs are growing that the Bush Administration would like to go that way. But it will have to be prepared to take a lot of short-term heat for eventual economic gain.

By Stan Crock in Washington, with Chester Dawson in Tokyo



CASPIAN RIG: *Tempting*

GLOBAL WRAPUP

USH'S CHINA SHOCK

Was it a gaffe or an important political signal? When President George W. Bush went on television on Apr. 25 in a series of interviews to celebrate his 100 days in office, he shocked China watchers by declaring that the U.S. would do "whatever it took to help Taiwan defend herself" if China attacked the island.

Bush's words seemed to mark a step away from the long-standing U.S. policy of "strategic ambiguity": For years, presidents have avoided openly stating

that America would militarily defend Taiwan, to deter Beijing from attacking and discourage Taiwan from provoking aggression. In a later interview, Bush confused matters further by reasserting U.S. support for the one-China policy—the bedrock of existing relations between the mainland and Taiwan. It assumes that the island will not declare itself independent.

Not to worry, says a White House spokesman. There's no change in U.S. policy. So what's the President up to? Bush may be talking tougher on Taiwan to appease conservatives—including

those in his Administration—who want him to do so. Bush's comments came a day after he approved a major weapons sale to Taiwan but not the destroyers equipped with Aegis radar systems Taipei wanted. Some conservatives were disappointed.

Intentionally or not, the President's comments are likely to shake up the Chinese leadership. Beijing already says the U.S. decision on Taiwan arms sales could bring "devastating damage" to the U.S.-Chinese relationship. Expect more tough talk from both Washington and Beijing.

JAPAN'S BO

After anointing self-proclaimed reformer Junichiro Koizumi as Japan's new Prime Minister, the faithful of the ruling Liberal Democratic Party called a rally at party headquarters. "*Gamboro!*" they shouted after tributes to their new leader. Rough translation: "Let's close ranks and kick some butt." Koizumi vowed to create a new LDP that "will stick out its chest and move strongly toward the future." Rich stuff, given that the LDP is a hornet's nest of factional intrigue and Koizumi himself could fall in a matter of months.

As the LDP's blue-suited brigade departed its nondescript headquarters in Tokyo, everyone knew Japan's ruling party had just embarked on a bold gambit. This, the stodgiest of Establishment parties, has selected as its leader a quirky maverick who favors austerity and pain—a hard sell for any politician anywhere. Even Koizumi rival Shizuka Kamei, chairman of

Cover Story

the LDP's Policy Research Council—who dropped out of the race before the Apr. 24 vote—marvels at how Koizumi pulled it off. "He looked like a white knight on a ride for justice," says Kamei. "That mesmerized our members."

By choosing Koizumi as Prime Minister, the LDP—or a big chunk of it, anyway—is trying to save its skin by selling the Japanese public on a policy shift toward true economic reform. Gone, its resident optimists will tell you, are the cushy contracts for political supporters and the bailouts that have been standard LDP operating procedure for decades. This policy about-face is risky: Many of the party's backers in industry dread the sting of reform and will do just about anything to avoid it. Koizumi faces many battles before he puts his program in play.

But much has changed in Japan, making the moment ripe for a reformer like Koizumi. In the mid-1990s, the LDP was in a state of denial about the depths of the financial and economic crisis. Monetary and fiscal policy was being held hostage by bureaucrats or LDP elders

KOIZUMI'S PLATFORM ...

- ▶ Push the banks to call in bad loans
- ▶ Spend \$30 billion to expand jobless benefits
- ▶ Cap government spending and gradually wind it down
- ▶ Target inefficiencies in Japan's shoddy pension system
- ▶ End government oversight of \$2 trillion postal savings system
- ▶ Have prime ministers directly elected by the voters, rather than party bosses



FORMER

Junichiro
Koizumi has
a radical plan

erned solely with protecting their interests. Now, thanks in part to easing pressure from a revitalized sition, Koizumi and his reformed allies are willing to talk can- about what needs to be done. The al bank is increasingly indepen- and no longer willing to allow cians to hijack monetary policy. even as policy is more openly de- l, voters are becoming receptive w ideas. "The fact that the rank- ile Liberal Democrats cast ballots

whelmingly in favor of Koizumi is a clear signal to the al Democratic Party that they have to change," says Mi- Makihara, chairman of Mitsubishi Corp. "It's a strong d, and I hope they'll react."

would be political and economic suicide for the LDP to ontinue its course of the last decade. As Koizumi says, without "resolutely implementing structural reform,"

Japan will face a far uglier reckoning later on. Tough love won't be fun in the short term, but other in- dustrialized nations have endured similar pain and emerged stronger. "If we prolong the current situ- ation," says Koizumi, "we won't get a recovery."

BACKROOM DEALS? As Japan's \$4.1 trillion economy lurches toward another recession, policymakers, investors, and business executives in the U.S. and Eu- rope can only hope Koizumi is the real thing. For years, the West has been waiting impatiently for Japan to halt its slide. The most recent fear is that a new recession in Japan will have a knock-on effect that will destabilize the rest of Asia, just as U.S. demand for Asian goods starts to mp. So Bush Administration officials are cautiously en- ging Koizumi—and ardently hoping he hasn't made any backroom deals that undercut his bold plans.

The results of past inaction by Japanese gov- ernments are painfully plain: a bourse that has lost 65% of its value in the last decade, a cratered property market, the biggest budget deficits in the

to restructure the dysfunctional economy, but the new Prime Minister has only weeks to act. Does he have a fighting chance?

world, and the most dysfunctional banking system among developed nations. The latest scary revelation to emerge from Japan: the number of nonperforming loans is far higher than previously estimated—perhaps not as high as the \$1.2 trillion claimed by the political opposition, but at least 25% higher than the most recent official figure of \$400 billion, according to ING Barings analyst James Fiorillo.

The driving need to defuse this financial bomb explains why Koizumi's fate is so important and why the world will scrutinize his every move in the coming days. Many are worried he'll fail the test and turn out to be a transitional figure—the politician who kicked off an important political realignment in Japan but failed to lead it. "Is this the first chapter of the New Japan?" wonders Clyde V. Prestowitz Jr., president of the Economic Strategy Institute in Washington. "Or another chapter of the Old Japan?"

That is the trillion-dollar question. Koizumi has only a matter of weeks to put coherent policies in place—not because the economy is about to fall off a cliff, but because the embattled LDP faces an upper-house election on July 29, a contest it is widely expected to lose. If Koizumi cannot stop a rout, he himself could be swiftly deposed by the party that just selected him for the top job. And even if Koizumi does win over voters in the July election, his struggles won't ease. He "could change politics in this country," figures Nasdaq Japan Chief Executive Officer Tatsuyuki Saeki. But make no mistake: "People will want to shoot him in the back." In other

... AND HOW HE COULD FARE

FLASH IN THE PAN

forms a credible Cabinet but its fierce factional resistance to workout on the banks. He goes h another big spending plan. suffers huge losses in the er House election, and Koizumi is forced to resign in August.

FATAL FACTIONALISM

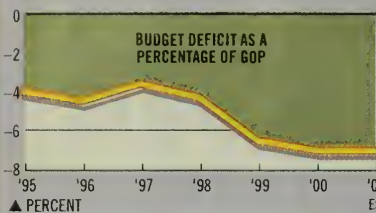
He puts together enough credible policies to pull the party through July's election, but then outlives his usefulness to LDP elders. The opposition can't muster the support for a no-confidence vote, and conservative factions oust him in September during the next party race.

KOIZUMI PREVAILS

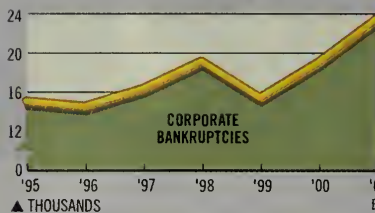
His government pushes through critical legislation, forges links with like-minded opposition parties, and readies the public for a recession in exchange for better days ahead. The Bank of Japan boosts the money supply further, the markets rally, and a real recovery gets under way.

JAPAN'S PREDICAMENT

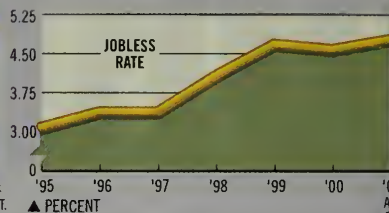
THE BUDGET HOLE GETS DEEPER...



...WHILE CORPORATE GLOOM SPREADS...



...AND UNEMPLOYMENT RISES



Data: Standard & Poor's DRI, Morgan Stanley Dean Witter & Co., Teikoku Databank, BusinessWeek

words, the old regime, and the special interests it represents, won't die without a bitter struggle.

Yet Koizumi does have a plan more ambitious than any LDP leader has proposed. The strategy has the support of the LDP rank and file and probably a large number of voters. Whether he can ram new legislation through before the government faces the voters is unclear. But elements of the plan tackle the core issues plaguing the economy:

■ **Bank reform.** LDP elders recently proposed a three-year plan to coax the banks into writing off their problem loans and start lending again to healthy companies. Critics say the blueprint refers only to some \$270 billion of the worst loans, or only about two-thirds of what analysts say is the real total of bad debt. Koizumi wants something closer to an earlier, tougher plan fashioned by Hakuo Yanagisawa, the top financial regulator. That could mean accelerating the timetable from three years to two, tackling a greater share of the bad

debt, and providing more public money to keep the banks afloat as they write off billions of dollars in dud credit.

■ **Jobless benefits.** Japan has nothing like the government-subsidized unemployment plans common in Europe and the U.S. And tough labor laws make it hard to lay off workers. Yet higher unemployment is inevitable if Koizumi forces the banks to call in loans and shove delinquent borrowers into bankruptcy. So he wants to create jobless benefits paying as much as 100% of a laid-off worker's pay for up to 12 months. Such a cushion could make a company's decision to lay off employees and restructure much easier.

■ **Social security makeover.** Because of Japan's rapidly aging population, the pension system will likely go

A PRIME MINISTER WITH PIZZAZZ

He wears flashy suits and bright ties that stand out in the land of the blue-suited politician. He sports an unruly crown of long curly hair—giving him a Beethoven look that appeals to Japanese women. He often speaks his mind—to the intense annoyance of his party comrades. And though at 59, he's a trifle old for this kind of thing, Junichiro Koizumi is a big fan of heavy metal music. When the lead guitarist of a band called X Japan committed suicide three years ago, Koizumi called his parents to console them.

Koizumi is also that rarest of birds in Japanese politics, a bachelor. Divorced in 1982 from his much-younger wife after fathering two sons, he has vowed never to remarry: He quips he doesn't want to go through the ordeal of getting divorced again. The new Prime Minister admits to spending time in the hostess bars of the Ginza district, and he has had a long string of girlfriends.

Whatever the details of his private life, this rake's progress has had an electoral payoff. Political writer Hisashi

Akiho of *AERA* magazine says Koizumi is popular with women because "they are attracted to someone who is rough."

Rough or not, Koizumi sports a political pedigree that is pure Establishment. His grandfather, Matajiro, was a former Vice-speaker of the Lower House. His father, Junya, served as head of the Defense Agency. Koizumi has a degree in economics from prestigious Keio University. Unlike most previous Prime Ministers, Koizumi speaks good English.

Koizumi was a graduate student at the University of London in 1969

DIVORCED

Koizumi says he won't remarry because he doesn't want another split





some time next decade out an infusion of new money. HSBC Securities economist Peter Morgan estimates the system is underfunded by \$1 trillion, or 100% of gross domestic product. So far, Koizumi's ideas for fixing social security are sketchy, but he hopes to root out waste and put more of a burden on the wealthy, once it is economically feasible.

Deficit spending. Budgets at both the central and local level out of control, with their total deficit adding up to 10% of GDP. No modern developed nation has run such deficits before. The Japanese government borrows \$40 million an hour, 24 hours a day," says Wilbur Ross, a U.S. investor now making money in Japan. Koizumi wants to cap government borrowing at

his father died. He moved back to Japan to run for his father's seat in the Diet. Defeated in the election, he then signed up to be secretary to Diet member Takeo Fukuda, who later served as Prime Minister.

Koizumi ran again for a Diet seat in 1972 and has since served 10 consecutive terms, working his way up the Liberal Democratic Party hierarchy to a senior position in the faction led by late Prime Minister Keizo Obuchi and then

Yoshiro Mori, who has just stepped down as Premier.

Koizumi has longed to be Prime Minister for years. In 1995, he got trounced running against then-rising

MORE HARD TIMES?

Homelessness and fire sales may become fixtures for years under belt-tightening

JAPAN'S ROCK 'N' ROLL LEADER

BORN 1942, Yokosuka City, Kanagawa Prefecture, heir to an LDP dynasty

EDUCATION Economics major at prestigious Keio University, graduate work at the University of London

CAREER HIGHLIGHTS Started as Diet member in 1972. Held various Cabinet posts. Tried three times to win top spot in LDP

FAMILY Divorced in 1982, two children

HOBBIES Japanese heavy metal music, Kabuki theatre opera

CHARACTER TRAITS Outspoken and ambitious; passionate about issues such as privatizing the postal savings system; manages to be both a maverick and a member of the mainstream LDP

LDP star Ryutaro Hashimoto—the man he defeated in the recent election—by running on a platform that focused on privatizing parts of the state postal savings system. He then served in 1996-97 as Health Minister and promptly alienated LDP colleagues by advocating an anti-smoking campaign. (Tobacco taxes are a source of income

\$245 billion a year by ordering the Finance Ministry to cap new bond issues.

■ **Privatizing the postal savings system.** This is the savings bank, run by the post office, in which millions of Japanese have stashed \$2 trillion in deposits. For decades, the money has been shoved into wasteful government projects, to Koizumi's chagrin. Of all his reform proposals, none fires him up like postal savings privatization. Japanese bankers, who view the system as a tax-subsidized monster that diverts deposits away from the financial markets, are amazed at Koizumi's intensity on the subject. "He has written a book, holds all kinds of seminars, and bet his entire political life on this issue," says Akira Kanno, vice-chairman of the Japanese Bankers Assn. "He is always giving us a scolding for not being more passionate about this." Koizumi would love to break up the postal savings system into regional savings funds, then eventually privatize them as individual banks.

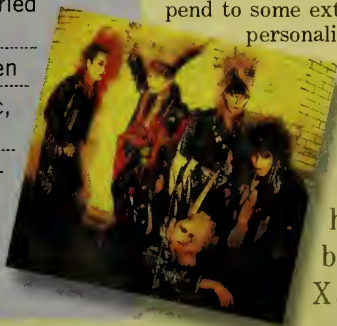
Koizumi will probably defer his attack on the postal savings system until he's sure his emergency program will pass. That may be wise: His proposals are not without considerable risk. For starters, fixing the banks will mean cutting off corporate borrowers. As a result, Japan's 4.7% jobless rate could surge to 6%, and 1.5 percentage points could be shaved off annual growth for the next two years. Koizumi's team needs to make sure that any spending cuts aren't so heavy that they push the economy deeper into recession.

Much of Koizumi's success will depend on whom he names to his Cabinet. As *BusinessWeek* went to press, it seemed likely that Yanagisawa, the taskmaster of the watchdog Financial Services Agency, would keep his job. And it looks like Koichi Kato, a fiscal hawk who wants to halt wasteful public works spending, will get the Finance portfolio. Economic re-

form for the Ministry of Finance.)

Indeed, Koizumi's contrarian political stands and unconventional personal life convinced many that he would never fulfill his ambition to lead the country. "None of us thought he would win, including Koizumi himself," says LDP Lower House ally Katsuei Hirasawa.

How long he serves may depend to some extent on another personality quirk. Hirasawa says



FAN

Koizumi is keen on heavy metal bands like X Japan

Koizumi can be quite unyielding when he takes a political position. If he bends too little, however, he could alienate the biggest factions in the LDP and still end up accomplishing little. Then he'd just be an empty suit—though a nicely tailored one.

By Brian Bremner
in Tokyo



former Taku Yamasaki is tipped to get the key job of LDP Secretary General. And outspoken Makiko Tanaka, daughter of the former Prime Minister, may also get the Foreign Ministry. Tanaka defied party elders by calling on the LDP faithful to support Koizumi.

While Koizumi is an untested maverick (page 98), his arrival on the scene comes at a potentially propitious moment. The Big Bang financial reforms set in motion four years ago by the Hashimoto Administration are forcing Japan to bring itself in line with international accounting practices. Consolidation of the financial sector over the past 18 months makes it easier to deal with the bad loans.

Moreover, the government's inability to fix the economy has forced Corporate Japan to rehabilitate itself. Increasingly, companies are spinning off noncore assets and cutting costs in an effort to make themselves globally competitive. Legislation has already been passed to make such spin-offs easier. And Corporate Japan seems prepared to back Koizumi. Says Tetsuya Katada, vice-chairman of the Japan Federation of Economic Organizations: "We expect him to implement reform measures without being bound by vested interests."

At the same time, despite their fears of increasing unemployment, a large number of Japanese voters finally seem to be coming around to the notion that there can be no gain without pain. In the

week before the Diet vote, LDP upper house member Yoshinori Hayashi was startled by how Koizumi's tough-love approach struck home with his constituents in southern Japanese cities.

Indeed, Koizumi cleverly exploited the deep anxiety among grassroots LDP members that the status quo, championed by former Prime Minister Ryutaro Hashimoto—who pitched go-slow restructuring and more government spending—would lead the party into the political wilderness. On the stump, Sunday talk shows, and on his Web site, Koizumi warned the party stood at "a crossroads that will determine whether the people of Japan completely give up on LDP governance or whether we are able to regain the confidence and trust of the nation." That played to the survival instincts of LDP members with vulnerable seats.

THE KOIZUMI CABINET: WHO MIGHT JOIN?

Possible reform nominees for key offices



KOICHI KATO

May get the Finance post. Has best reformist credentials: launched a popular but doomed revolt to unseat the Prime Minister last year.



SEA CHANGE

Japanese voters seem to be finally coming around to the notion that there can be no gain without pain

The new Prime Minister also tapped into residual anger among the LDP rank and file over the closed-door selection of his predecessor, Yoshiro Mori, last year. Lower-echelon party members were simply not consulted, and the Mori Cabinet's subsequent gaffes, scandals, and witless economic policy turned the party into a laughing-stock. Bringing an end to Japan's faction-driven politics is another of Koizumi's passions. He argues that annual

met shuffles reward political loyalty, not talent. He says the system kills perfectly good policy ideas in the cradle. **“NOTHING WILL CHANGE.”** But the fact remains that Koizumi could not have triumphed without the support of the very ones he affects to despise. One of those is co-managed by policy chief Kamei, who is among the party's most formidable power brokers. Kamei is almost certainly expecting a sort of payback—and he may try to pressure Koizumi to make a tax cut. The new Prime Minister defeated rival, Hashimoto, head of the LDP's largest faction, may choose to water down legislation that threatens the interests of his backers

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in the construction and post office business groups. Also, it's one thing to abandon such big LDP supporters in an intraparty beauty contest but quite another to spurn their support in national campaigns that require lots of cash. “The factions will not be able to betray their vested-interest supporters so easily,” reckons Robert A. Feldman, Morgan Stanley Dean Witter & Co.'s Tokyo-based chief economist.

Nor can Koizumi expect to forge a coalition with the opposition. Democratic Party of Japan leader Yukio Hatoyama dismisses any talk of his opposition bloc teaming up with a renewed LDP to create a reform-minded government. When push comes to shove, says Hatoyama, the LDP won't turn on its business backers.

“Nothing will change,” he insists. The DPJ and its opposition allies

think they'll grab control of the upper house and force a general election by the fall, no matter who leads the LDP.

So, is Koizumi the right man for one of the world's most thankless jobs? He is certainly ambitious. This is his third run at the LDP presidency in six years—in 1995 he lost to Hashimoto, and in 1998 he was bested by late Prime Minister Keizo Obuchi. And he has demonstrated the ruthlessness required to succeed in Japanese politics. Last November, when fellow reformer Koichi Kato led a rebellion to oust Mori, Koizumi didn't lift a finger to help, instead sticking by the Premier despite his disastrous record. Then, when Mori resigned in disgrace in early April, Koizumi made his move and elicited the support of Kato and other reformers.

Japan's 11th Prime Minister in 12 years is also pragmatic and not above seeking the counsel of his elders. Merrill Lynch & Co. chief economist Jesper Koll points out that Koizumi has wisely sought out the patronage and advice of ex-Prime Minister Yasuhiro Nakasone, generally viewed as Japan's strongest postwar leader, who successfully managed an anti-mainstream ticket during the mid-1980s. Says Koll: “Japan now has a leader with a vision and a purpose.”

The burning question is whether Koizumi be around long enough to turn that vision into policy. Japanese voters have seen self-styled reformers storm into power only to be disgraced by scandal or co-opted by the LDP bosses. If Koizumi joins that list, count on more policy gridlock when the economy can least afford it. But for now, Japan has a glimmer of hope, and Junichiro Koizumi has a chance to make a difference.

By Brian Bremner and Robert Neff, with Ken Belson, in Tokyo, and Julia Lichtblau and Irene M. Kunii in New York

HAKUO YANAGISAWA

The heavy on finance reform. An LDP insider, he has firm ideas on how to fix the banks but has been blocked so far. Would run the Financial Services Agency.





TELECOM

LUCENT'S DARK DAYS

Even as it fights to survive, the company is hamstrung by the lack of a permanent CEO with a product strategy

Henry B. Schacht has been a busy man since returning to Lucent Technologies Inc. as chief executive last October. In January, he unveiled plans to consolidate the company's 11 business units into four. Then he eliminated 10,000 jobs, some 9% of the workforce. In February, he won a \$6.5 billion line of credit to give the company much-needed cash. The effort is resulting in modest improvement at the deeply trouble telecom-equipment maker. On Apr. 24, the company reported revenues of \$5.9 billion for the second fiscal quarter, up 36% from the previous quarter, and a slightly narrower operating loss of \$1.8 billion. Its stock rose \$1.05 on the news, to \$10.25. Turning around Lucent "is a matter of execution and focus," Schacht says. "There's no magic in this. There's no new knowledge required. This is just hard work."

But all of Schacht's hard work may not be enough to save Lucent. While the onetime CEO of Cummins Engine Co. has focused his efforts on fine-tuning Lucent's operations, he may be tinkering with an engine that simply needs to be rebuilt. Schacht's strategy, which he put in place when Lucent was spun off from AT&T Corp. back in 1996, is to emphasize the

breadth of the company's products and services, rather than developing cutting-edge products in a few key niches. At the same time, many phone companies are asking for just the opposite. "What we do is buy best-of-breed technology and integrate it ourselves," says Richard G. Ellenberger, chief executive officer of Broadwing Inc., a telecom company in Cincinnati. "It's very difficult for a single equipment maker to be best of breed in every category."

That's not even Lucent's goal. Schacht and other Lucent executives say it's simply not that important to have the best product if you can offer a telephone company a complete communications network as well as services such as installation and maintenance. The evidence suggests otherwise: Many Lucent customers buy key products from its rivals, particularly in the fast-growing markets for optical equipment and Internet routers. For example, local-phone giant Verizon Communications Inc., Lucent's largest customer, buys its routers from Cisco Systems Inc. and others. Without competitive products in key areas, Lucent is in jeopardy of losing its status as the top supplier of communications gear in the U.S. "Lucent is

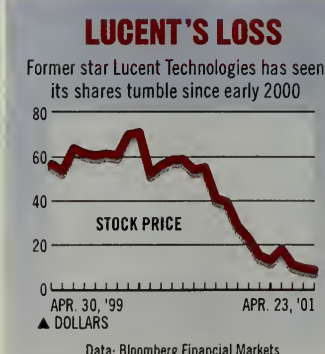
likely to fall from its No. 1 position third or fourth by the end of 2000," says analyst Steven D. Levy of Lehman Brothers Inc.

Certainly, Lucent's problems go beyond its soup-to-nuts strategy. Under former CEO Richard A. McGinn, it used questionable accounting practices, aggressive lending to customers to try to meet its 20% revenue growth target. When the tactics backfired, Lucent's

stock plummeted, McGinn was ousted last fall. About the same time, telecom companies started running into financial trouble and started cutting back on their purchases from Lucent as well as from Cisco and Nortel Networks Corp. Just last month, one of Lucent's big customers, WinStar Communications Inc., filed

for bankruptcy protection, owing Lucent \$700 million that it may never pay back.

The avalanche of troubles could mark the end of Lucent, a once-proud company that traces its lineage to the inventor of the telephone, Alexander Graham Bell. Its shares have dropped 85% from a 52-week high of \$67 and are barely above the offering price of \$7 when Lucent was spun off from AT&T in 1996. While its February credit line will keep the

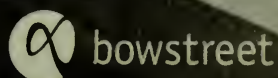


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CHA-CHING.



"This industry is about great products.... And for a long time, Lucent has been coasting on older products"

pany out of bankruptcy for the foreseeable future, Lucent's market cap has sunk so low, to \$30 billion, that it could be taken over or sold in pieces to rivals, such as Germany's Siemens or France's Alcatel. "We continue to believe that a breakup or merger remain distinct possibilities," says Tom Lauria, telecommunications-equipment analyst at ING Barings LLC. Schacht wouldn't comment on takeover speculation, but says Lucent can survive on its own. Even though it's burning cash at a fierce rate, he says bankruptcy can be avoided through asset sales and cost cutting.

Just as Lucent is fighting for its life, the company is constrained by the lack of a strong, permanent CEO. Schacht, who ran the company from 1996 to 1997, agreed to return on a temporary basis after the board fired his protégé, McGinn. Trouble is, after six months the board can't find a suitable candidate willing to take the job. Former General Electric Co. executive W. James McNerney Jr. was approached about the post several months ago, according to J.P. Morgan Chase & Co. analyst Gregory S. Geiling. But the highly regarded executive decided to run 3M Co. instead. Another candidate, former Nortel executive F. William Conner, also chose a different job—the helm of Net security upstart Entrust Technologies Inc. Now board members are targeting Krish Prabhu, chief operating officer at Alcatel, according to one Wall Street analyst and another source close to the situation. Prabhu could not be reached for comment. Investors think speed is of the essence. "People aren't really paying that much attention to second-quarter numbers. They want to know who the next CEO is going to be," says Jeffrey Heil, director of equity investments for the Regents of the University of California, which sold almost all of its Lucent shares in March.

Schacht insists that Lucent's leadership is strong. He says the company is

more closely managed now than it was during the McGinn era. For example, his core management team meets every Monday and Friday, compared with once a month for McGinn's group. He would not comment on the potential candidates and says there is no fixed timetable for finding a new CEO. "I do not view myself as interim," he says. "We have put together a plan and a program to which everybody is fully committed, and we're in the process of executing, and there's total concentration."

And rather than being a problem,

LUCENT'S CHALLENGES

After finishing the most traumatic year in its history, the communications-equipment maker still faces major hurdles.



FIND A NEW CEO: Lucent must quickly find a successor to CEO Henry Schacht, who stepped in after former CEO Rich McGinn was fired last fall. Schacht has strong operating experience, but he lacks the tech knowhow of his peers at rival companies.

RESTORE FINANCIAL HEALTH:

Lucent hasn't reported a profit since September, which has pushed its bond rating down to one level above junk status. Lucent must find a way to return to profitability by next year.



CONTINUE TO CUT COSTS:

Schacht has said that 10,000 jobs—9% of the workforce—will be eliminated. Analyst Tom Lauria of ING Barings says Lucent needs another wave of job cuts, perhaps as large as the first.

OVERHAUL R & D:

Lucent is still having trouble getting the right products to market at the right time. It blew the boom in optical transport equipment. Now it has the LambdaRouter, a next-generation optical technology that cuts costs up to 90%. But the market won't develop for at least a year or two.

Schacht insists that Lucent's strategy is a competitive advantage. He predicts that the makers of one or two hot products, such as CIENA Corp. in optical gear, will falter eventually, even if they do well in the short term. "There is a debate in the industry: Are you better off focusing on one single segment of the industry?" says Schacht. "But what does CIENA do when it fills up demand for hot boxes that have a short shelf life? I think the long-term survivors will be companies that provide a range of service to big [telephone] carriers."

Lucent also insists its products just fine. It won't report revenue segment, but it points to rising sales in its speedy digital subscriber line equipment and a \$5 billion wireless deal from Verizon in March. In April, Deutsche Telekom ordered an undisclosed amount of optical equipment for a multinational network. "Throughout our lineup are moving resources to next-generation products," says Executive Vice President William T. O'Shea.

Time, Schacht figures, is on his side. The troubles in the telecom industry

trigger the bankruptcy of many upstart and widespread consolidation among remaining players. The survivors are likely to be Verizon and the other phone giants, which happen to be Lucent's best customers. Lucent stands to benefit from consolidating markets, Schacht says.

LOOMING LAYOFFS

Schacht has a lot of work to do to put the company back on his right. Lucent has been losing market share since last September and is expected to continue to bleed cash into the red ink for the rest of this year. In the first quarter, the company's gross margin were 17%, down from 49% two years ago. By contrast, Nortel's margins in its first quarter were 25%, Lauria thinks Lucent may have to lay



10,000 more employees to get its structure in line. At the same time, the company's cash balance dropped to \$1.4 billion in the latest quarter, down from \$3.8 billion three months earlier. To stay afloat, the company has been selling assets. It expects to complete an auction for its fiber-optic-cable manufacturing business and raise another \$5 billion in the next few weeks.

Any change in strategy may have to wait for a new chief. Rivals say Lucent's current approach won't work unless it has top-of-the-line gear to

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plement its product breadth and support services. "What we found is that most carriers are looking for best-of-breed solutions," says Hugh Martin, CEO of optical upstart ONI Systems. Other industry experts agree. "This industry is about great products," says Vinod Khosla, a general partner at venture-capital firm Kleiner, Perkins, Caufield & Byers, who has backed Lucent rivals Juniper and Corvis. "If you don't have them, you don't get anywhere. And for a long time, Lucent has been coasting on older products."

Yet developing new technologies may be particularly difficult for Lucent these days. The cost-cutting measures of the past few months could hurt its long-term product development. The budget for research and development fell to 17% of total revenues in the latest quarter, from 22% just three months earlier. And analysts expect R&D to drop to

15% of sales by the end of September. By comparison, Nortel's R&D budget was 13% of sales last year, even while analysts believe it did a better job of developing crucial new technologies. Lucent says it's simply returning to its historic spending levels of 12%.

Even before the cuts, the company was having a hard time getting the right products to market at the right time. For example, carriers are currently buying a switch that uses optical and electrical signals to transport voice and data. But Lucent has pretty much ceded the market to CIENA. The upstart will sell an estimated \$170 million worth of switches this year, according to Merrill Lynch & Co., and that will rise to about \$500 million in 2004.

Lucent has developed a pioneering all-optical switch, called the LambdaRouter. While Global Crossing and several other

unnamed carriers are testing the switch, there hasn't been a single sale. J. Kim, the new president of Lucent's optical-networking group, says demand for the LambdaRouter will take off this year and in 2002. But customers agree. Verizon says it will be at several years before a market develops. "We don't have the LambdaRouter on our radar right now," says Paul A. Couture, president of Verizon's network services group.

A few years ago, it might have been possible for a single company to be a soup-to-nuts supplier. But in an age of digital convergence, it's proving nearly impossible for one carrier to master both optical and data networking to less and voice switching. It may take a new CEO before Lucent figures that out.

By Steve Rosenbush in New York with Amy Borrus in Washington

'THERE ARE NO SILVER BULLETS AVAILABLE'

Lucent Technologies Inc. is counting on the steady hand of Henry Schacht. He ran Lucent for two years after it was spun off from AT&T in 1996. When the board fired his protégé Rich McGinn last year, Schacht agreed to return as CEO and chairman while directors search for a successor. He talked with Telecommunications Editor Steve Rosenbush at Lucent headquarters in Murray Hill, N.J.

What went wrong with Lucent?

In retrospect, we tried to grow the company too fast. The decision to concentrate more on the [competitive local-phone companies] proved to be ill-fated. The 11 [new-business] units did not produce the new products that were hoped for, but developed an expense structure that was unsustainable. We made a conscious decision to offer discounts [to boost sales]. When that didn't work, we had a hole.

What changes have you made?

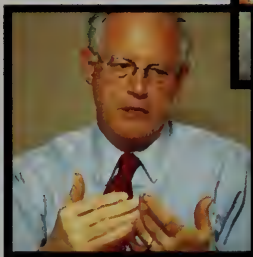
No. 1, we slowed down the anticipated rate of growth. We then took our 11 business units and worked them back to [four] product-development units. We're seeing progress on all seven points of our restructuring plan. And we're focusing Lucent on the needs of service providers for

broadband and wireless infrastructure.

What else will it take to get Lucent back on track?

This is a matter of execution and focus. There's no new knowledge required.

There are no silver bullets available. This is just hard work.



SCHACHT

"This is a matter of execution and focus"



tomers who are going to dominate the business, a combination of very large service providers and specialist service providers. It doesn't mean the CIENAs and the Junipers [rival equipment makers] won't do very well. I think they will. But I think the people with staying power are going to be the people who are able to deal at the next level of an integrated solution.

How are you motivating staff?

We took options down to the \$12 range. We've gone to a fast vesting. But basically my view is what keeps people at a place and motivated is a sense of direction, of purpose. Our

turnover is way down. I don't think retention or motivation is an issue.

When will the stock recover?

Having disappointed during the year 2000 and done it pretty consistently over the year, the mantra around here is performance counts, talk doesn't. My own view is we'll restore credibility as performance improves and not until. And I think that's quite appropriate.

What's your outlook for the telecom-equipment market?

We're going through a bad period. But over time, the technology sector and the communication sector are going to grow robustly, certainly by double-digit [rates].

What's Lucent's competitive edge?

Our view is that the survivors are going to be the people that offer the most integrated solution to the cus-

COMMENTARY

By Joseph Weber

NURSING HOME CARE: CODE BLUE

A few weeks before last Christmas, Helen Tomlin was ready to go home. After five months in a nursing home, where she had been linked to a ventilator that pumped air into her emphysema-racked lungs, the 76-year-old grandmother was keen to see her family. "She was feeling better. She was smiling," recalls her husband,

homes, it is an extreme example of mistakes that are becoming all too common. Already, substandard care has become the shocking norm at too many of the nation's 17,000 nursing homes (table, page 108). Bedsores and malnutrition are rife, and mentally incapacitated residents occasionally flee to wander on nearby roads. Industry executives say finding qual-

industry's finances are so parlous that six of the country's biggest for-profit chains—including Integrated Health Services and Genesis—slipped into bankruptcy reorganization in 2000. In Nevada and New Mexico, nearly half of homes operate under court supervision, as do more than 20% of those in 12 other states.

But there's a more fundamental

problem. Haphazard national policy has turned the industry into a tortured, quasi-governmental affair begging for reform. Medicaid is designed to help the poor. But many have taken advantage of the rules by switching their parents' assets out of their name. The families then get to keep their inheritance, and the nursing home tab gets dumped onto taxpayers. "We artificially impoverish them, that gets them nursing home care, and we get early inheritances, and attorneys line their pockets," complains Stephen A. Moses, president of the Center for Long-Term Care Financing, a Bellevue (Wash.) nonprofit.

TROUBLE AHEAD. Because we haven't officially acknowledged that Medicaid has become a middle-class entitlement

program, Congress never sets aside enough dough to keep the system fully funded. The result: Nursing homes are fast going backward toward the chronic maltreatment of the 1960s. The Bush Administration has proposed a few tax incentives that would help a little. But the problem will only get worse if we don't tackle it head-on: As the elderly population swells, it will double federal nursing home spending by 2010 and continue to soar thereafter.

Washington will have to come to



CREAKY Substandard care is the shocking norm at too many nursing homes—a problem Washington needs to address as it ponders tax cuts

arold. But on Dec. 7, he got a devastating call from the Bellbrook (Ohio) home. A maintenance man had mistakenly hooked a nitrogen tank to an oxygen system that supplied Mrs. Tomlin and other residents. She and three others died, and six were hurt. The Tomlin family is suing for \$10 million, and criminal indictments have been lodged against the home's owner, Integrated Health Services Inc., and the gas tank supplier. Both have pleaded not guilty.

A tragic aberration? Sure, but for 7 million Americans in nursing

homes, it is a dire problem. "There is not enough money in the overall system," says Michael R. Walker, CEO of Genesis Health Ventures Inc., a national home operator.

At one level, the issue is simple economics. Unwilling or unable to provide for their waning days, too few people set aside enough money or buy insurance to cover nursing care. So much of the bill has fallen to the government. Of some \$96 billion a year going to such homes, about \$58 billion comes from federal programs, mostly Medicaid. Even so, the



grips with the dilemma. One extreme would be to formalize nursing home funding, perhaps through a Social Security-like system that collects worker and employer contributions in every paycheck. The opposite tack would be to insist that middle-class families foot the bill themselves (although devising rules to prevent asset-switching has proved to be difficult). A middle position could be to use tax incentives to persuade the middle class to purchase long-term care insurance, an idea Congress has toyed with in recent years.

Whatever approach we adopt, a national dialogue should take place as part of any discussion about 10-year tax cuts. Otherwise, Washington may be forced in a few years to ask taxpayers to foot the bill, in effect giving back all the cash lawmakers now plan to dole out. As it stands, "we have no coherent long-term care strategy in our country," says Charles H. Roadman II, head of the American Health Care Assn., a trade group.

CRAZY QUILT. Repeated seesawing on policy and funding by Washington and the states has added to the confusion. For example, when congressional budget-balancers wielded their knives in 1997, they slashed Medicare funding and changed the rules under which nursing homes operated. This rendered uneconomical many ancillary businesses that industry players had created in response to earlier government incentives, such as respiratory therapy and rehabilitation. Washington again changed the rules in 1999 to help the industry, only to later cancel its "refinements" after government officials objected. Finally, President Clinton offered a salve to the ailing industry last year by chipping in

some \$1.6 billion over five years as part of a Medicare relief bill—an amount industry leaders say is scarcely enough.

The problem is exacerbated by the wildly different amounts of government money homes get around the country. Washington pays 57% of the cost of Medicaid, with the states picking up the rest. But states administer the program and set many of the rules. The result is a crazy quilt of reimbursement levels, ranging from \$122 a day in North Dakota

to more than \$340 a day in Florida. Care levels vary, too. Texas pays

about \$296 a day, but government investigators have found that at least 25% of homes there operate with rule violations that hurt residents or put them at risk of death or serious injury.

President Bush has a few proposals that at least begin to address the nursing home problem. To jump-start long-term care insurance, he wants to broaden a Clinton-era tax deduction. He also would let families take a personal exemption for the elder if they care for at home. Moreover, the federal government plans next year to give federal employees the chance to buy group long-term care coverage. Companies should follow suit. Such coverage were to become as common as 401(k) programs, it would help steady the system's finances.

Still, government can't shirk its role as funder of last resort and policeman. Truly needy seniors—who might not have well-off descendants to turn to—cannot be turned out of the street. Regulators also must make sure that staffing ratios and care are appropriate. Mandatory staffing ratios that had been considered in the 1990s ought to get a fresh look.

As Congress ponders tax cuts, nursing home care should be part of the debate. "The American public is more than ready for a dialogue," argues former Senator David Durenberger, chairman of an advocacy group called Citizens for Long Term Care. We owe our parents and ourselves no less.

GOLDEN YEARS
More elderly will tax the system further

NURSING HOME SQUEEZE

DETERIORATING CARE...

- ▶ Six companies, representing 12% of the U.S.'s 17,000 homes, are operating under Chapter 11.
- ▶ Some 54% of homes provide less than the minimum recommended two hours of attention a day per resident.
- ▶ Nearly one-third offer less than the minimum recommended 12 minutes a day of care by a registered nurse.
- ▶ Last fall, random surveys by federal inspectors found "violations that caused harm to residents or had the potential to cause death or serious injury" in homes from New Jersey to California.

...AND SOARING COSTS

(Government spending on nursing homes)

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Data: Health Care Financing Administration

Weber covers health-care issues from Chicago.



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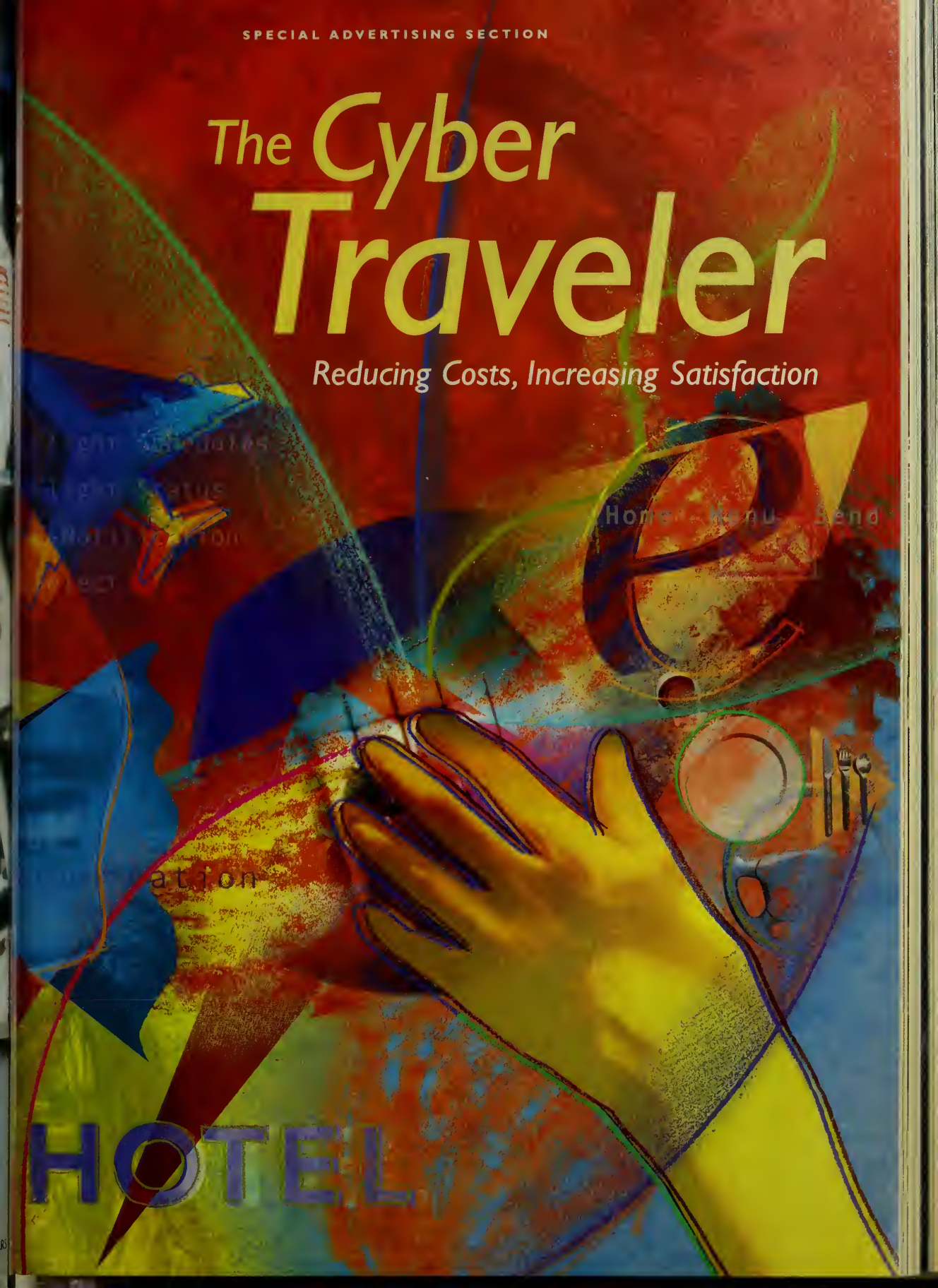
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- When purchasing travel direct from supplier inventory without a travel agent or any other kind of middleman makes the most sense, and when it absolutely doesn't.
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Touring the Top Travel Sites

Despite a few spectacular dot-com crash-and-burns (Savvio.com didn't make it to its first birthday; Priceline is poised at the precipice), a few new upstart sites are generating a lot of interest, and the veterans-Travelocity, Expedia, and biztravel.com-continue to make enhancements as users grow in numbers and enthusiasm.

Travelocity.com recently enhanced the site with a Business Travel Center. Features include Express Search, which allows users to search for flights by date, time, and specific airline; Repeat A Trip, which allows travelers to design and store up to 25 itineraries for flights, car rentals and hotel stays; Mobile Solutions, which brings real-time travel information and booking capabilities to Internet-enabled cell phones or wireless hand-held devices; Flight Status, which lets travelers monitor arrival and departure status, gate and baggage information and weather reports; Flight Paging, which alerts travelers to information that affects their schedules; and a currency converter.

SideStep lets PC users running Internet Explorer download a plug-in that searches for flights, hotel rooms and rental cars while Expedia or Travelocity hunts for the same information in an adjacent window. Customers are then forwarded to airline, hotel and car rental Web sites to complete the transactions. "That lets the suppliers retain greater control of the customer experience and cuts out the fees that they pay to distribution systems," explains SideStep CEO Brian Barth.

At the newly redesigned Business Travel channel on **Hoover's Online** (www.hoovers.com),

a combination of top-flight travel information and tools from companies like ontheroad.com, **trip.com** and wcities.com make the site an excellent one-stop information resource for travelers. Features include a booking engine, through trip.com, for air, car and hotel; city guides to 100 destinations worldwide; FlightTracker, one of trip.com's most popular features,

traveler's permission, to purchase travel within the account of the individual who is actually taking the trip. (The traveler can access personal itineraries and make changes at any time.) The Repeat a Trip features allow travelers to book the same flight, hotel and rental car from a previous trip, and to synchronize itineraries with the personal calendars on their desktop or laptop computers. These new features build on

Mileage-Miner, a service for managing various frequency programs, and Expedia To Go™ mobile services. Business travelers make up about one third of the customer base of Expedia, which developed the technology

used by American Express' corporate travel booking engine, said John Pollard, director of business travel and mobile services.

YOUPriceit.com lets consumers bid on airline tickets for domestic and international travel. Travelers enter where they want to go and how much they want to pay. YOUPriceit.com then searches airlines and participating vendors to try and match (or beat) the bid. With the use of contracted fares, consolidators and other discounts, YOUPriceit.com may save the traveler as much as 75 percent on airline tickets.

Despite a few spectacular dot-com crash-and-burns, a few new upstart sites are generating a lot of interest.

which allows users to check the status of flights between major U.S. cities and minimizes time spent waiting at the airport; maps, driving directions; e-mail travel alerts for specials on fares and hotel rooms, and an online copy center sponsored by Mimeo.com that can print, bind and deliver important documents directly from any PC application.

Expedia.com® has recently launched an impressive new Business Tools section. The Travel Arranger feature allows a planner, with the

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Savvy Suppliers

Home Menu Search

Enterprising suppliers are honing their Web offerings to match corporate objectives and purchasing patterns. The products and services showcased here fall into two categories: the ones designed for travel purchasing, and the ones geared to making the travel experience better-faster-easier for the road warrior.

For the company

Companies trying to control travel spending by employees all over the world are using Cytric®, an Internet-based corporate travel system created by Frankfurt-based **i:FAO**. Instead of making bookings from a corporate Intranet site, Cytric, which is compatible with whatever IT system your company uses, can be accessed via any computer with Internet/Intranet access.

Want to keep travel costs down while keeping employees in touch—with customers, suppliers and colleagues? Virtual meeting services from **WebEx** (www.webex.com) are helping boost productivity substantially as they save impressively measurable dollars. WebEx provides Web-based communications services to corporations, business portals, communications service providers, Web-application providers and online marketplaces. All of WebEx's real-time communications services run over the WebEx Interactive Network (WIN), the only global network designed specifically for real-time Web communications.

The WebEx services provide this collaboration functionality without requiring pre-installed software or firewall configuration. Texas Instruments

uses WebEx to keep far-flung team members communicating frequently; Symitar Systems, a provider of computer systems and ATM networking products for banks and credit unions, uses the WebEx Meeting Center "to whet the appetites of interested prospects," according to Kathy Hooker, national sales manager; Ron Schneider, first vice president of training and performance

powerful tool. One of Oracle's recent WebEx virtual conferences brought together participants in Argentina, Mexico, Chile, Brazil and the U.S.—with nary a plane ticket.

Another supplier of virtual meetings is **PlaceWare** (www.placeware.com). With it, the presenter uploads PowerPoint text, graphics and other enhancements (annotation tools, streaming audio and video, etc.) into the PlaceWare application, and then points the audience to the URL where the meeting is scheduled to occur. Everyone who logs on can share in the visual presentation, and interact with each other from their offices, hotel rooms or homes.

Web conferencing is unique because any type of visual content that can be presented in person can be presented over the Web—and then saved in a file for future reference.

Diners Club's Web site features the ATM Locator and the Merchant Locator, which allow Cardmembers to locate merchants and ATMs that accept the Diners Club Card, with the simple click of a mouse.

development at Countrywide's wholesale lending division estimates that using WebEx is saving "more than four million dollars per year."

One of WebEx's biggest customers is Oracle, which uses the system to enhance sales presentations. "A WebEx virtual presentation is the ultimate illustrated phone call," says David Thompson, vice president of sales and marketing for WebEx. It's an extraordinarily

For the traveler

Want to make those pesky expense reports less of a hassle? **Diners Club International** has made a significant upgrade to its online functionality for Corporate Card customers: online corporate billing statements. Corporate Cardmembers now can quickly access their current Diners Club Card account information via the

Internet from anywhere in the world. Online statements enable J.S. Corporate Cardmembers to view their billing statements and Club Rewards balances online. (Enrollment is necessary and can be done online.)

Diners Club's Web site also features the ATM Locator and the Merchant Locator, which allow Cardmembers to locate merchants and ATMs that accept the Diners Club Card, with the simple click of a mouse. To find merchants accepting the Diners Club Card, Cardmembers go to (www.dinersclub.com), and click on the "Merchant Information" icon at the top of the screen. To utilize the search tool, enter an address or city and state in the U.S. The tool identifies locations up to a 50-mile radius from the starting addresses indicated by the Cardmembers. The ATM Locator not only helps locate cash machines throughout North America and Europe, it also maps the exact directions to ATMs. For more details, call 1-800-2-DINERS.

Last December, **Northwest Airlines** began offering Internet check-in throughout its entire domestic system. Passengers can print their own boarding passes from their home or office computers, right on regular paper. They may also use the site to change to a different flight, change or confirm a seat assignment, enter or change a WorldPerks number or reservation or request an upgrade. Internet check-in is available less than 24 hours and more than 90 minutes

prior to departure. For info: (www.nwa.com/checkin).

Want to turn your hotel room into a combination information hub and entertainment center? A joint venture with **Hilton**, LodgeNet Entertainment Corporation and InnMedia is bringing digital entertainment, high-speed Internet access and other information and communication services to Hilton guests this year. On-demand digital services include hit movies, music and Nintendo; a video checkout service that e-mails hotel receipts to guests; high-speed Web browsing on the TV; on-demand films and access to archived programming from HBO; instant access to up-to-the minute news, weather and sports; "Send A Greeting" e-postcards and a "Virtual Concierge" electronic compendium of local and hotel information.

Have to book a meeting on short notice? **Embassy Suites Hotels**, which just won its second consecutive "Highest Guest Satisfaction Among All-Suite Hotel Chains" award in the J.D. Power and Associates 2000 Hotel Guest Satisfaction Study, lets you perform site selection, reserve room blocks and arrange for meeting room setup, catering and audiovisual equipment online through the company Web site (www.embassysuites.com). A conference coordinator will be assigned to your meeting to help with the arrangements and to supervise the function while it's being held.

*A joint venture with **Hilton**, LodgeNet Entertainment Corporation and InnMedia is bringing **digital** entertainment, high-speed Internet access and other information and communication services to Hilton guests this year.*

Need an admin at 25,000 feet? **GTE Airfone** just began offering dictation and transcription services by iDictate.com to passengers on airliners that have advanced digital Airfones. For details and special offers: (www.idictate.com/airfone).

Meanwhile, **Tenzing** is now providing business travelers with in-flight Internet access and e-mail capabilities. The Seattle-based company has been beta-testing its in-flight service on **Air Canada** since last September, and Asian carrier **Cathay Pacific** is in the process of installing the Tenzing service—which is compatible with PCs, Macs and PDAs—on its entire fleet.

Best Flight Schedules Practices

How are the country's most innovative companies using the World Wide Web to control corporate travel expenses? They're using it for everything from streamlining the reservations process, to controlling reservations at point of purchase, to processing expenses.

Here are a few best practices when it comes to purchasing travel:

Building a comprehensive corporate travel Intranet site.

These are helping companies keep travelers informed on everything from policy (who can buy what kind of travel, including which suppliers to use and which kind of flights can be booked), to special fares and rates, to the best way to get from the airport to the local sales office or plant. More often than not, companies with Intranets are attaching online booking systems to these sites. So it's a quick leap from information to reservation.

More often than not, companies with Intranets are attaching online booking systems to these sites. So it's a quick leap from information to reservation.

Encouraging self-booking.

Self-booking sites help companies save significantly—usually about 20 percent for online bookings compared to those made using a travel agent. Companies like

Lucent, Motorola, Thomson Consumer Electronics and Citibank all have seen significant reductions in ticket prices when travelers researched and booked tickets themselves.

Helping to make the business case for self-booking systems: they generate savings not only from lower average ticket prices, but also from lower transaction fees for the corporate travel agency.

Watching meeting spending.

How do you create any kind of purchasing efficiencies when there are dozens if not hundreds of small meetings being planned

at your company and no single person overseeing how they're booked?

One way is to pool group purchasing with that of individual travelers.

At Microsoft, for example, any travel to a meeting, even if a zone fare is used, is credited to the

transient travel air volume, said Kathy Rust, events commodity manager.

A corporate travel Intranet also helps facilitate control over group expenses. Companies like Joseph A. Seagram & Sons, Hewlett-

Packard and EMC are keeping meeting costs down by mandating that any offsite meeting be registered through a meetings page on the corporate Intranet. That way, different managers holding meetings in the same city at the same time can book together, get preferential hotel rates for a multi-meeting contract and potentially save on ancillary meeting items, such as catering, ground transportation and air.

Many companies are also keeping an eye on meeting spending by using the Diners Club or American Express corporate meeting card. At Storage Technology Corporation, the streamlined procurement and payment process of the Amex Meeting Card gets high marks from Randy Krumpeck, manager of travel and meeting services. Krumpeck, who estimates his company charges about \$2 million annually on the Card, said that "it's making life much easier for us because we now cut a single check once a month to pay our meeting bills, where before we were sitting down a dozen or so times each month to prepare multiple payments to vendors. On top of that, our company is saving thousands of dollars, because we're holding on to our money longer." For information: (www.dinersclub.com) or (www.americanexpress.com).

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What's up in Wireless

Frequent traveler Andrew Menkes, the former travel manager for HSBC Bank and now president of Partnership Travel Consulting, knows a thing or two about making travel less of a slog. On a recent business trip to Chicago, his meeting was wrapping up sooner than expected.

He discreetly took out his wireless PDA, checked for earlier flights, switched his reservation and got home in time to beat a nasty snowstorm. "I never travel without it," he says of his PDA. "It's perfect example of how wireless is changing—for the better—life for the business traveler." Wireless travel management now comes in many forms from many sources.

Want to book, cancel, rebook with nary a phone call?

Amadeus's Wireless Travel Management (WTM) product lets travelers check flight availability and book or cancel flights on 500+ airlines from a mobile device. Passengers can make reservations for any flights leaving between two hours and 12 months from the moment they access the service.

Sprint PCS has partnered with Chicago Consulting Partners (CCP), the eBusiness consulting firm and developer of wireless solutions, to bring wireless applications as a way to extend the Ariba Buyer™ eProcurement application. The CCP solution will enable enterprise customers with Ariba Buyer to wirelessly submit travel requisitions, track the approval process, and act upon requisitions requiring approval via any Sprint PCS Internet-ready Phone. For info: (www.sprintpcs.com).

Like to check in without waiting on line?

Lufthansa now lets you check into your flight using your WAP. (Most passengers use the service on the way to the airport.) You can also download Lufthansa information

Lufthansa now lets you check into your flight using your WAP. (Most passengers use the service on the way to the airport.)

services on your mobile phone by selecting (wap.lufthansa.com). You'll find out about arrival and departure times and gate information for all Lufthansa domestic flights. The corporate Web site (www.lufthansa.com) has a nifty little demonstration that shows exactly how easy the check-in and information-requesting service is.

Need info?

Singapore Airlines Mobile Services can be accessed via WAP-enabled communications devices. Flight schedules can be accessed up to six months in advance; flight alerts notify you of the arrival or departure of flights through SMS (Short Message Service), on pagers and e-mail. And

with Flight Status, you can view real-time arrival and departure information on all Singapore Airlines-operated flights (which excludes code-share flights). Register for the service at (www.singaporeairlines.com) or through your WAP device.

Visitors to the **Hertz** Web site, (www.hertz.com) can now download 29 city guides from Portable Internet™ to their hand-held computers. The Hertz version of the Port@ble Guide™ includes a Hertz location finder, telephone number and operating hours for each branch; a vehicle guide; and interactive maps, local business listings, restaurants and hotel reviews, an address search engine and driving directions to selected points of interest.

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Design: Sundberg & Associates, Inc.

Produced by: MeigsMedia, Ltd. Millbrook, NY
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A STAR ALLIANCE MEMBER

COMMENTARY

By Mark Hyman

HOW BAD IS THE NBA HURTING?

Basketball junkies who've been mourning the retirement of Michael Jordan for three years are in for a shock on Apr. 21. The playoffs kicked off with the most compelling matchups in recent memory. For example, the defending champion Los Angeles Lakers and Portland Trail Blazers exchanged elbows in an unexpectedly free first-round pairing.

Fans seemed plenty engaged, too. San Antonio, which led the league attendance, 33,983 showed up to watch the Spurs tangle with the Minnesota Timberwolves on Saturday. Playoff games in L.A., Milwaukee, New York, and Sacramento all rated sellouts.

In the post-Jordan era, the rap has been that the NBA is going backward. Goal-oriented workaholics such as Jordan, Larry Bird, and Magic Johnson have been replaced by players who take pride in tattoos and tough-guy personas than in winning, critics say.

THE MODELS. But is the NBA's sluggish image being overstated? Is there a worthier role model than the aging machine Tim Duncan of the Spurs or ball-handling whiz Steve Nash of the Suns? Both led their teams into the playoffs with style and humility. And, unlike Dennis Rodman, bad boy of the Jordan era, neither has shown up on TV in a wedding gown.

Not in dispute, though, is that the NBA's TV ratings still suffer from Jordan's 1998 exit. They are down 35% since the NBA signed its new network contract with NBC and Turner four years ago. "Michael Jordan created an artificial blip in the ratings. He attracted a lot of people to the NBA who didn't ordinarily watch," says former CBS Sports President Neal Pilson.

The NBA's current deals—worth \$6 billion—expire after the 2001-02 season. A tight-lipped Commissioner David Stern says only: "We're expecting to increase our network television agreement." But industry insiders predict the league will net a premium at best. More than a

15% boost might be out of reach.

That would be weak tea for the NBA, which doubled the value of its broadcast deal last time around, and very different from recent TV negotiations involving other big leagues. Last year, for instance, Fox handed over a 50% boost for baseball's All-Star Game, playoffs, and World Series—despite eroding ratings.

Jordan could give some oomph to a potentially stagnant network TV contract. By the time the deal is signed for the 2002-2003 season, the twice-retired, 38-year-old icon may be in uniform again. Although Jordan says he has made no decision about playing for the woeful Washington Wizards, the franchise he partly owns, he has been working out with the team. And friends say he's leaning toward comeback No. 2.

Unfortunately for Stern, even the return of His Airness wouldn't clear a lane to the basket. Unlike the cable piece of the TV pack-

age, over which Turner and ESPN are expected to struggle, it's hard to see where the action for network rights will come from. NBC has a strong interest in retaining the games, which are the cornerstone of its depleted sports lineup. Since its last deal with the NBA, the network lost the NFL, suffered through the Sydney Olympics, and endured a disaster with the ratings-poor NFL.

Two potential buyers probably couldn't make a pitch for the games if they wanted to. Fox is showcasing NASCAR during the height of the NBA season; CBS is locked into coverage of NCAA basketball, culminating with the highly rated Final Four. That leaves ABC, which airs a hodgepodge of golf, college hoops, and figure skating opposite the NBA and which hasn't been spending on expensive sports programming lately.

Commish Stern isn't conceding anything. But privately he must be praying for more playoff action, Michael redux—and fewer tattoos.

Hyman is contributing editor for Sports Business.

TV ratings are 35% below the Jordan era, but the playoffs are hot and Michael may be back

THE SIXERS' ALLEN IVERSON



HIGH-END CARS,
SEARCHING
FOR SAFETY,
ONLINE DEALERS

BusinessWeek Lifestyle

Giving the Baby Bimmer A Run for Its Money

BMW is sharing the road with new starter luxury cars



BY JOANN MULLER

For years, the BMW 3-Series sedan has been the car to beat in the entry-level luxury market. A few auto makers, notably Audi and Mercedes-Benz, tried to emulate BMW's success, but they never came close to matching the Baby Bimmer's appeal and driving dynamics.

But now, BMW finally faces some credible competition. Its German rivals are back with far better vehicles starting at just under \$30,000. The new Mercedes C-Class, which went on sale last fall, offers the kind of comfort and luxury you would expect from Mercedes, but in a sportier, more stylish package. And Audi is getting ready to introduce a larger, faster A4 sedan that's sensuous and sporty.

The Germans aren't the only ones getting into the act. Jaguar, Lexus, and Acura are all challenging BMW with new models aimed at younger drivers who crave comfort, performance, and of course, pedigree. Soon, Lincoln, Cadillac, and Infiniti will join the fray, too, making the low-end luxury car segment the most competitive in the industry.

VOICE-ACTIVATED PHONES. Why so many new offerings? Luxury car buyers tend to be recession-proof, but unless dealers hook them early, it's tough to lure them away from their favorite brand. The intense competition means manufac-

turers are under pressure to hold down prices while loading up their vehicles with goodies such as navigation systems, electronic stability control, and voice-activated radio and telephone.

Most cars in the category start at a little more than \$30,000, but the price can easily rise to \$40,000 if you choose a more powerful engine and lots of the extras available. Still, in some cases, you can get a well-equipped vehicle for less than \$35,000. With so many attractive features, you might wonder why anyone would

spend more for a higher-end car. That's easy: These luxury cars might be loaded, but some of them don't seem much bigger than a Honda Civic. So they're definitely suited for families with kids.

My husband and I learned just how tight the C-Class is on a recent trip to Florida with our children. We couldn't fit the stroller and all our luggage in the trunk, so my five-year-old had to rest her feet on the extra suitcases. Another problem was that after a couple of hours riding in the 10-way, electronically adjustable front seats, both my husband and I were complaining of lower back pain. It turns out our C320 did come equipped with an optional multicontour seat that includes lumbar support, which I highly recommend.

In every other way, the C-Class offers the kind of el-



**JAGUAR
X-TYPE**

BASE PRICE
\$29,950

ONE COOL INSTRUMENT PANEL



LEXUS IS 300

BASE PRICE
\$30,500

egance and comfort you'd expect in a much higher-priced sedan. That includes genuine wood trim, rich leather seating, and an optional premium Bose stereo system. The C240, starting at \$29,950, comes with a 2.6-liter, 168 hp V-6 engine and either a six-speed manual transmission

or a five-speed automatic transmission with Touch Shift, which allows drivers to manually shift gears without using a clutch.

We tested the more expensive C320, (starting at \$36,950) which features the Touch Shift automatic and a 3.2 liter, 215-hp, V-6 engine that accelerated briskly, tickling the back of my neck as we sped down Highway 1 toward Key West. Standard features include a telescoping steering column, electronic stability control, and eight airbags. For \$2,190 extra, you can add an integrated, voice-activated telephone and CD changer. Ours featured a sunroof package for \$1,340 that included a rain sensor (which the wipers on automatically when it detects

des) and a nifty electronically controlled shade in the rear window that helped keep kids cool along those Florida highways. Mercedes isn't done yet. Borrowing a page from it will soon start selling wagon and coupe versions of the C-Class.

ED AUTOMATIC. Lexus is also going after youthful, sporty reputation with its new IS. Until now, the luxury division of Japan's Toyota Motor had only its Camry-based Lexus ES to challenge the 3-series. And like most luxury vehicles, the ES 300 is competent and handsome, but very dull. Not so the IS 300. Its exterior styling is aggressive and angular, but what really sets it apart is the interior. Not one will like it, but I think it's awesome. The most distinctive feature is the instrument panel, which is styled like a chronograph watch



dial. Admittedly, it's a bit tough to read the gauges, but I got over that quickly.

Other cool touches include drilled aluminum foot pedals, metal skid plates for the door sills, and a chrome-plated shift knob. Best of all, Lexus has finally brought some driving passion to its lineup with this sports sedan, which starts at \$30,500. The IS 300 features a smooth, 3.0-liter, 215-hp, six-cylinder engine and—for now, anyway—a five-speed automatic transmission. (A manual version is scheduled to come out later this year.) On tight corners or bumpy surfaces, the IS 300's double-wishbone suspension and responsive steering keep the car on track. Even the color of the model I tested—solar yellow—screamed excitement.

QUICK ACCELERATION. For car buyers seeking a bit more refined luxury, the new Jaguar X-type goes on sale this summer starting at \$29,950. This compact is unmistakably Jaguar, with its sculpted shapes and powerful stance. And although we weren't yet allowed to test-drive the X-type, the car's V-6 engine and four-wheel drive system promise to deliver a potent combination.

The Baby Bimmer, redesigned in 1999, still sets the standard among entry-level luxury vehi-



MERCEDES C-CLASS SPORT

BASE PRICE
\$32,900

cles. Even though the Baby Bimmer's businesslike interior seems a bit dated compared to today's more modern styling, what matters most is the way that it drives. And the 3-series is a driving enthusiast's dream. It handles corners tightly, accelerates quickly, and stops swiftly. It's a car that begs to be driven. The lowest-priced 3-series is the 325i sedan, which starts at \$27,635, but there are many derivatives of this vehicle. The most expensive in the 3-series is the 330Ci convertible sport model, which tops \$52,000 fully loaded.

After all your shopping, you may find you still drive a BMW home from the dealership. At least now, if you do, it won't be for lack of other great choices. □



BMW 330i

BASE PRICE
\$33,990

Luxury car buyers tend to be recession-proof—and loyal. Auto makers are vying to hook them when they're young with lower prices and lots of goodies



When You Want To Whisper 'Class'

The Bentley Arnage has power and precision galore

BY DAVID WELCH

The top brass at Rolls-Royce & Bentley Motor Cars insist their Bentleys are not pretentious cars for the ridiculously wealthy. They are sporty luxury cars that power down the highway with brute motoring force, rather than the soft ride and styling elegance of a Rolls, offers Alasdair M. Stewart, president and CEO. Says Stewart: "If you want to make a statement, buy a Rolls-Royce."

Still, after four days driving a \$211,000 Bentley Arnage Red Label around Detroit, I had the uneasy feeling of being overdressed. In a nation of relentlessly dull Ford Tauros and Toyota Camrys, the Bentley stands out like fine wool in a mob of polyester. The other problem is that you live in fear of incidental scratches and door dings. A detail job just to take out the minor scratches that come from everyday parking costs \$180—more than twice the price for normal cars.

But if you have to ask what anything about the Arnage costs, you can't afford it. Of course, you get quite a bit for its princely sum. It takes a month to hand-build a Bentley on the company's assembly line in Crewe, England, which moves slower than three feet per minute. That attention to detail gives the car its amazing precision. No squeaks and rattles here.

Inside, Bentley uses the best materials it can find. In my test vehicle, champagne-colored burr

BENTLEY

THE ARNAGE'S 6.75-LITER V8 ENGINE GOES FROM ZERO TO 60 MPH IN 5.9 SECONDS

oak surround entire dashboard, the center console where the stereo and environmental controls are located. The wood is custom-finished for each car over 17 days.

group of craftsmen at the Crewe plant. The buttercream-colored leather on the car took about 12 days to custom-cut and sew onto the seat frames. The result is ornate. Leather covers the dashboard, and the burr oak runs across the instrument panel, circles the custom-finished gauges, and continues through the center console.

SENSUOUS. The seats are as comfortable as a leather recliner—though I didn't know they had much on the posh seats of cars such as the Lexus LS430 or Infiniti Q45. Both of those cars also have rear seats for rear passengers, and the seats in the Lexus vibrate, giving passengers a nice massage. You don't find those kinds of gadgets, nor even the latest in audio, on an Arnage.

The Arnage has power that you don't find in luxury cars don't: a massive 6.75-liter V8 engine with a turbocharged

400-horsepower engine can push its 5,850-pound car of bulk from a standstill to 60 miles per hour in 5.9 seconds. For its size, the Bentley is quick and very smooth. There is no lag between hitting the gas pedal and powering ahead, as you often find in turbocharged cars.

The Arnage exterior stands out even to its styling is subdued when compared with more classic lines of its Rolls-Royce cousin. The car is a bit boxy from the side view. But the front end, with the windshield, long, sensuous curves rearward to the highway. The chrome grille and 18-inch chrome wheels give it a sporty look.

The Arnage may not have the turning panache of a \$360,000 Rolls-Royce Corniche, but it oozes class and has a strong presence.

The Arnage is a blend of supreme luxury craftsmanship combined with speed and performance. Within two years, that rare mix may be more affordable. When the company splits from Rolls-Royce in 2003—Volkswagen takes BMW gets Rolls—a \$150,000, mid-sized Bentley will hit the market. Stewart says Bentley will emphasize its Crewe plant to crank out at least 10 of the smaller Bentleys a year, vs. current production of about 1,200 of the Arnage, Azure, and Continental T cars annually. Let's hope speeding up the assembly line doesn't water down Bentley's integrity. The auto business needs a gold standard, and Bentley is it.



It takes a month to hand-build a Bentley; the leather alone takes 12 days to cut and sew

safety in Numbers

More extensive ratings can help you buy a solid car

JEFF GREEN

The rural roads in Jolie Morris' neighborhood near Clear, Alaska, can be tricky. So her car's crash-test safety record is important to the 25-year-old mother of two. But when it came time to replace her 1999 Nissan Quest, she did more than just look at government safety ratings. Morris says she pored over car magazines and scanned the Internet for information before deciding on a 2001 Volkswagen Jetta.

Morris had to dig deeper not because there's a dearth of safe cars. Thanks to such engineering feats as side air bags and stability control systems, auto safety has improved to such an extent that the government ratings are no longer enough to delineate the different advantages of various models. Last year, 88% of the cars tested by the National Highway Traffic Safety Administration (NHTSA), which issues the government ratings, made the top two rankings of four and five stars, vs. only 31% in 1979.



What the Ratings Mean

NATIONAL HIGHWAY TRAFFIC
SAFETY ADMINISTRATION
nhtsa.gov

One- to five-star ratings are regarded as effective measures of air bag and seat belt performance.

INSURANCE INSTITUTE
FOR HIGHWAY SAFETY
www.hwysafety.org

The IIHS test measures the structural strength of the vehicle. Vehicles are rated from poor to good.

CONSUMER REPORTS
consumerreports.org

Combines NHTSA and IIHS data with its own subjective assessment of safety features such as side air bags and stability control systems. Ratings go from poor to excellent.

With the safety gap between the best- and worst-performing cars closing fast, consumers have been seeking ways to augment the NHTSA rankings. Since 1992, the Insurance Institute for Highway Safety, an industry group, has been doing crash tests of its own. And this year, Consumers Union, publisher of *Consumer Reports*, came up with its rating system. Each has a different procedure for determining safety. So by comparing the various assessments, a buyer can get a more complete picture of how much protection that model in the showroom provides.

By law, all cars sold in the U.S. offer a mandated minimum amount of protection for a crash at 30 mph. To come up with its ratings, NHTSA crashes new cars at 35 mph head-on into a wall to determine the level of safety beyond the minimum. It also tests for crashes from the side

and calculates a vehicle's rollover tendency, based on such factors as weight and height. Its lowest rating—one star—suggests that occupants would suffer serious or even life-threatening injuries in a crash. Drivers of a car with at least a four-star rating can expect a 20% or less chance of serious injury. Morris' Quest scored four stars for driver safety and three for passenger protection. Her new Jetta had five stars in both categories.

The IIHS takes a different tack. It crashes cars into a barrier at an off-center angle to simulate the head-on collision of two vehicles that aren't lined up directly. Offset crashes are more dangerous to occupants, the IIHS says. Experts consider the IIHS's four ratings, which range from poor to good, as a reliable measure of a car's structural strength. Under IIHS's system, the Jetta was third in its class, a still strong showing.

OBSTACLE COURSES. Consumers Union, meanwhile, doesn't do crash tests. Instead, it combines NHTSA and IIHS crash results with its own evaluation derived from driving a vehicle through a rigorous obstacle course. The system, with rankings from poor to excellent, made its debut in April in the 2001 *Consumer Reports* auto guide. According to *Consumer Reports*, the Jetta is among the safest cars on the road.

If you're car shopping, and safety is a top consideration, you would do well to first narrow your choices to models with at least four NHTSA stars. Bear in mind that the NHTSA test is considered an effective measure of air bag and seat belt performance. Then see whether the cars also make it to the top three places in any of the IIHS and *Consumer Reports* safety categories. That was Morris' approach. "I've seen some horrible accidents," she says. You can never be too safe. □

FINDING A GOOD
CAR DEAL,
BUFFETT MOVES
INTO GAP

BusinessWeek Investor

The Clicks-and-Bricks Way To Buy That Car

The Web is useful, but it won't put salespeople out of business

BY ROY FURCHGOTT

When repair costs threatened to outstrip the value of my Volkswagen Fox Wagon last summer, I finally admitted it was time for a new car. It had been 11 years since I'd bought one, and I knew I would have to educate myself on the vast changes in technology. Not car technology, but car-shopping technology.

Some 60% of car shoppers now do research or make purchases on the Internet, says market researcher J.D. Power & Associates. The Net barely existed when my two-door wagon was shiny-new. I soon discovered that while the Net put a virtual showroom on my desktop, it put all of the typical car salesman tricks there, too: the bait-and-switch, the special markup, and the ever popular "I'll have to check with my manager." But I still found the Net to be a powerful consumer tool. Although it didn't deliver a sweet deal on a car, it sure helped me sidestep bad ones. I ended up using a clicks-and-bricks shopping strategy—and that served me pretty well.

SQUEEZE. First, I had to find the right car. I needed one that could haul bikes and friends to cycling events. Checking car company Web sites along with a host of independent auto sites, I looked at wagons (too domestic), sport-utility vehicles (too huge), and eventually came to the Honda CR-V and the Subaru Forester, small, four-wheel-drive vehicles. Either could handle back roads to the mountain-bike trails and squeeze in four adults and their gear.



After perusing Yahoo!'s car (table, page 130), which was especially easy to navigate, I settled on a Subaru. Like some of the other Yahoo's let me make a side-by-side comparison of the cars and read consumer comments. It also allowed me to make a list printout—of options that included the in-or wholesale, price and manufacturer's suggested retail price (MSRP) for each.

I had to leave my desk for the next so I visited a Subaru dealership in Annapolis, Md., for a test drive, and even tried to make a deal. Then and there, the saleswoman offered to sell me another car. I would have the car.



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Armed with the best info the Web could provide, I walked into a dealer and said to a salesman: "Would you be happy making \$400 over invoice on a Forester?"

day. But the prices she claimed as invoice were, according to my Yahoo information, actually above retail. She insisted my info was wrong, but I doubted her. While a February report by Brandon (Ore.)-based CNW Marketing Research showed that pricing information on independent car sites is wrong about 70% of the time, it cited Yahoo as among the 30% with reliable data.

Having done the test drive, I weighed the idea of buying my car online. It's uncertain whether you save money going this route. A January CNW report found that purchases online cost an average of 4% more than the best dealer price. But J.D. Power says online buyers save some \$490 more than showroom shoppers.

I took heart from a friend's experience. He closed an excellent lease deal on a Jeep at priceline.com with just an e-mail and a phone call. The car was delivered to his home, and he says it took five minutes to sign the papers. He paid priceline's fee by credit card. Unfortunately, priceline didn't then operate in my state (it's in all 50 states now). After eliminating sites that wanted money up front (one charged \$300, with no low-price guarantee), I checked out Autobyte.com, Carclub.com, Autoweb.com, and the now defunct CarOrder.com. They let me configure the model as I wanted while tallying both invoice and retail prices. By then, I had gleaned a rule of thumb in the industry: Dealers are happy to make \$300 to \$400 over invoice for a \$20,000 vehicle. That became my benchmark.

RIGHT AWAY. Some sites, such as CarsDirect.com and formerly CarOrder.com, let you order directly. In such cases, the site purchases the car from a dealer in your area where you go to take delivery. CarOrder's price on the Subaru before tax was \$1,435 above invoice last summer. So I abandoned that approach.

At the other sites, I put down my contact information so an area dealership could call me. From my posting on Autoweb.com, a Subaru dealer in Springfield, Va.—more than an hour away—called to say that it had the exact car I wanted on the lot. The salesman offered to sell it at below invoice cost if I would take delivery right away. But I was fairly certain that the dealership didn't have a car with all the options I wanted. The Annapolis dealer I visited had

scoured the region to find one and failed. important, because I had checked the car on the Web, I knew the price offered exceeded invoice by about \$2,000. Heck, it was actually quite higher than MSRP. When I told the salesman this, he said he'd have to check with his manager.

That was the last I heard from him.

Autobyte, meanwhile, put me in touch with a dealer 40 minutes away. While the dealership didn't have the car, the salesman said he could order it—but there would be an "AMV," or "adjusted market value," charge of \$1,500 because of the demand for the model. Perhaps, my friend's salesman suggested, his manager might let me knock the fee down to \$1,000. "No thanks," I said, using words more polite than the salesman was thinking.

I don't think the dealer from Carclub.com called, but no matter. By this time I was tired. I took my itemized worksheet with me, and I calculated the dealer's base price and extras calculated to the invoice price and drove to Valley Mall in Timonium, Md., about 20 minutes away. There, I asked the salesman closest to the dealer to respond:

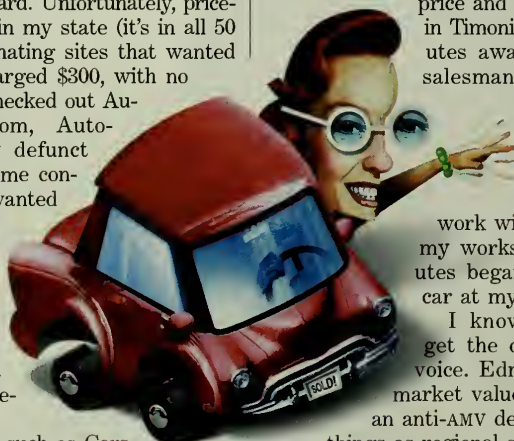
"Would you be happy making \$400 over invoice on a Forester? Matter-of-factly, I responded: 'I

work with that.' I handed him my worksheet, and in five minutes began the paperwork for the car at my price.

I know you sometimes get the dealer to go under invoice. Edmunds.com has a "market value" calculator—a sophisticated anti-AMV device. It factors in things as regional supply and demand, dealer rebates that might affect a car's price (for example, Subarus are cheaper in Florida where demand is low for four-wheel-drive with side-mirror defrosters).

So maybe I didn't pay absolute rock bottom, but I got something for my money. The salesman, Bill Kasper, kept me up to date on the car's progress on its way to the dealership. He even agreed to trade the stock gold-and-black wheels for the more subtle silver five-spoke wheels that I found more appealing. When the Subaru arrived, he showed me how to use all the features, including the many ways to arm the alarm. And he has graciously taken the time to repeat the information on follow-up phone calls. Try getting that on the Net.

AUTOS



Car Talk

AUTOBYTE.COM

Offers prices, e-mail updates on recalls, timed service reminders. Also, a "for her" page for nongearheads.

AUTOS.YAHOO.COM

Provides research and links with resources to buy, sell, and maintain a car. Easy to use for model comparisons.

AUTOWEB.COM

Connects buyers with dealers of new or used cars. Lets you apply for loans and insurance.

CARCLUB.COM

Includes car reviews and consumer opinion, side by side comparisons, and top-10 best deals.

CARSDIRECT.COM

Lets you order cars on the Web. Gives low-price guarantee. Research, financing, and insurance are also available.

EDMUNDS.COM

Has software to help you pick the right car. Shows videos of tests on racetracks. Lets you download car specs to your Palm device.

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WARREN BUFFETT: SLAVE TO FASHION?



BY ROBERT BARKER

The columnist dreams he is the Sage of Omaha and must explain his uncharacteristic investment in a hard-pressed retailer like Gap

Dear Reader,
I am setting aside my usual column to share with you an unreal daydream I fell into the other day. Get this: I was Warren Buffett! And I was preparing my answer to one question sure to come up on Apr. 28, when investors descend on Omaha for Berkshire Hathaway's annual meeting: Just what is Berkshire doing in a fashion-slave stock like Gap?

—RB

Well, now, that's a fair question, especially since our other recent buys include jazzy paint and brick companies. We don't own all that much of Gap, and I would hate to break our longstanding policy against talking about trades. But if you check the disclosures that Uncle Sam made us file on Apr. 2, you'll see we picked up 8 million Gap shares last year. My old buddy "Mr. Market" a few days ago said they were worth \$200 million. Don't trust that crazy guy, though. It's a fair bet they're worth more—and I'm not saying that just because we started buying Gap stock when it was a whole lot higher (table).

MISTAKES. To see what I mean, anyone can just walk into the nearest Gap. And I mean anyone, almost anywhere. Planet Earth now has some 3,750 Gap, Old Navy, and Banana Republic stores. That number grows daily, and by year's end Gap expects over 4,200 stores—a doubling in four years. Here in Omaha, we've got nine, about as many as we have Dairy Queens. DQ is another Berkshire holding that, like our favorite stock, Coca-Cola, defines ubiquity. And I like ubiquity.

So I urge you to visit a Gap. You'll see deals on karate pants (\$29.50) and an even one on cargo pants (\$24.99, marked down \$42). But look over your fellow shoppers. You'll see teenagers, alone and in groups, seeing their parents' money freely. You'll see women, alone or pushing infants in strollers. You'll see aging baby boomers buying clothes that forgive them their paunches. You'll see grandfatherly guys like me. Look, and see Gap now is the No. 1 cradle-to-grave clothing store.

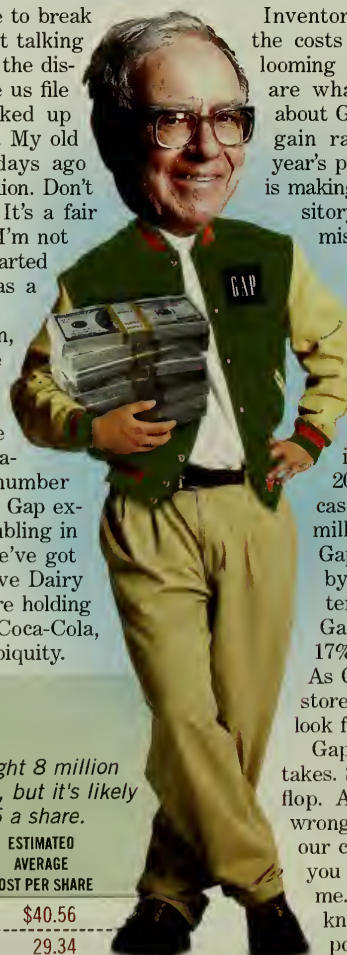
If you're a careful shopper, you'll also see how tough the retail apparel business can be. Just examine the market in boxer shorts. This spring Gap is trying to sell \$12.50 boxers in some prints, with hula dancers, little fishies, or (watermelons, limes, blueberries). On any rack only 10 feet away are last season's boxers. They're identical, except they feature different little fishies or frogs. They're going for \$3.

Inventory mistakes like this, along with the costs of Gap's global expansion and a looming slowdown in consumer spending, are what have Mr. Market so worried about Gap. He put the shares on the gain rack, where they're half off their year's price. But this is where Mr. Market is making his usual error: focusing on situational mistakes and weaknesses, missing Gap's enduring strengths.

Gap's current financial performance hides the potential profit power of its unusual apparel franchise.

This year looks as tough as last year, when sales expanded 18%, to \$13.7 billion, but profit shrank 22%, to \$877 million. That's the bad news. Despite it, Gap's retailing machine in 2000 generated almost \$1.3 billion in cash. With that, plus another \$1 billion in reserves and borrowed money, Gap expanded its retail floor space by 31%—a giant leap, especially after a 28% jump in 1999. This year Gap sees square footage grow 17% to 20%. After that, 15% growth. As Gap's expansion slows and its stores become more established, investors look forward to big growth in cash flow.

Gap is bound to make fashion mistakes. Surely some of its new store openings flop. And if tomorrow I conclude I was wrong about Gap, I would sell and move our capital in a better investment. You won't hear a word about it from me. As you, my fellow shareholder, know, Berkshire has a longstanding policy against talking about trades.



Buffett Falls into the Gap

Warren Buffett's Berkshire Hathaway last year bought 8 million shares of retailer Gap*. The precise cost is unknown, but it's likely above where Gap has recently traded, near \$26 a share.

PERIOD	SHARES PURCHASED (MILLIONS)	HIGHEST POSSIBLE COST PER SHARE	LOWEST POSSIBLE COST PER SHARE	ESTIMATED AVERAGE COST PER SHARE
APR. 1-JUNE 30	2.4	\$53.13	\$28.00	\$40.56
JULY 1-SEPT. 30	5.6	39.13	19.56	29.34
WEIGHTED AVERAGE		43.33	22.09	32.71

*Most recent data show Berkshire held 8 million Gap shares as of Dec. 31. Since then, it could have expanded, trimmed, or eliminated its position without yet having to disclose any trades.

Data: Company reports, BusinessWeek estimates

BusinessWeek online

For barker.online, go to www.businessweek.com/investor/ and click on "Columnist"

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it's just some

friendly competition

(if there is such a thing)

2001 race schedule

April 3	Dallas, TX	(214) 340-2456
May 1	New York City #1	(212) 423-2248
May 9	San Francisco, CA	(415) 586-8508
May 24	Albany, NY	(518) 435-4500
May 29	Frankfurt, Germany	(011-49) 69 68 60 7015
May 31	Rochester, NY	(716) 624-8245
June 14	Buffalo, NY	(716) 816-RACE
June 20	New York City #2	(212) 423-2248
June 21	Boston, MA	(617) 439-7700
July 11 & 12	London, England	(011-44) 207-620-4117
July 17	Stamford, CT	(914) 682-0637
July 19	Morristown, NJ	(973) 898-9386
July 25	New York City #3	(212) 423-2248
July 31	Long Island, NY	(516) 349-7649
August 7	Syracuse, NY	(315) 446-6285
August 9	Chicago, IL	(773) 777-9000
August 14	Paramus, NJ	(973) 898-9386
September 25	Atlanta, GA	(404) 255-1033, x10
October 6	Championship NYC	(212) 423-2248
November 14	Sydney, Australia*	(011) 61-2 94 39 6060

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www.nytimes.com

JIFFY STOCK STORY

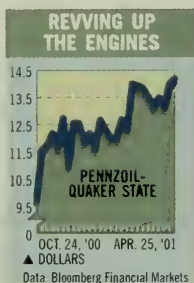


GENE G. MARCIAL

To technicians—the analysts who chart a stock's daily gyrations—Pennzoil-Quaker State (PZL) is an enticing stock that's about to break out to new highs. And to the pros who track fundamentals, this global automotive consumer products company is a turnaround story with appeal to both value and growth investors.

Andy Addison, a technician who heads his own advisory firm, says the stock has "formed a base" at 10 a share at the start of 2001 and has been pushing up since. Now at 14, "it could well hit 18 by the end of the year," he says. Insiders, he notes, recently have been buying shares. At J.P. Morgan H&Q, analyst Jay Wilson sees "solid fundamentals and attractive valuation" in the company which, he says, represent a terrific opportunity for growth, income, and value investors. Wilson says profit growth should average 40% over the next two years. And, he adds, the stock sports a hefty 5.7% dividend yield.

The company was formed when Pennzoil and Quaker State merged in 1998. It has since sold assets, including oil refineries in Louisiana, which are expected to net \$133 million. The company has evolved from an integrated oil concern to one specializing in automotive consumer products. It now sells 1,300 items, including the top-selling Pennzoil and Quaker State motor oils, in 50 countries and operates 2,000 fast-lubrication Jiffy Lube and Q-Lube service centers. The asset sales will crimp revenues by about a third, says Wilson, but will improve margins and the quality of earnings. The proceeds will help Pennzoil-Quaker State reduce its \$1.3 billion debt by at least \$200 million by yearend, figures Wilson. The stock is trading at 13 times his 2001 estimate of 95¢ per share, and 9 times his 2002 estimate of \$1.35 per share.



WILL VIACOM BE A BLOCKBUSTER?



RABINOWITZ

Investors' anxiety about the dragging economy eclipsed the upbeat first-quarter results that Viacom (VIA) reported on Apr. 24. Bolstered by acquisitions, the media and entertainment giant's quarterly revenues soared 90%, to \$5.75 billion, and earnings before interest, taxes, depreciation, and amortization (EBITDA) zoomed 145%, to \$1.15 billion. But investors weren't impressed: Viacom's shares fell nearly 2, to 51.30 a share that day. With 50% of Viacom's revenues coming from advertising sales,

shareholders worry the slowdown will hurt future revenues. Indeed, Viacom expects second-quarter cash flow to shrink due to a weak TV ad market and a possible actors/writers strike.

But some Viacom bulls think the worry is overblown. "The stock's current weakness is an opportunity to buy the values that Viacom represents," says Lewis Rabinowitz, president of R. Lewis Securities, who has been a long-term Viacom bull. He first bought into Viacom in December, 1987, when the stock was trading at a split-adjusted 21. He trimmed his holdings when it ran up to 76 last August, but came in for more when the stock fell to 40 later in the year. "Viacom could double in 12 months" as the economy starts snapping back, says Rabinowitz.

Mario Gabelli, whose mutual funds own a 7% stake, also expects Viacom to be a winner when the economy improves. And Merrill Lynch's Jessica Reif-Cohen calls Viacom "a compelling value." Despite the tough ad market, she says, "we continue to believe Viacom will excel relative to its peers in both tough and strong times."

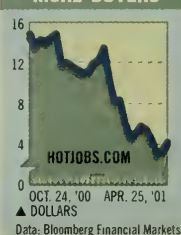
HOTJOBS MAY START LOOKIN' WAY COOL

Although its stock, like that of most other dot-coms, has plunged 75% from its high in October, Hotjobs.com (HJOB) may surprise the Street with better than expected first-quarter results, says a source close to the online job recruiter. Hotjobs' 9,100 corporate clients include IBM, Microsoft, PricewaterhouseCoopers, and Nike. They subscribe to its services and each pays basic monthly fees that account for 74% of Hotjobs' revenues. Employers usually pay big contingency fees to other agents for each job compared with an average monthly fee of \$800 paid to Hotjobs.

Revenues have been zipping up, from \$9 million in 1999 to \$97 million in 2000. CEO Dimitri Boylan says that despite the slowing economy, employers in both tech and nontech companies continue to hire skilled workers, in part because they are available following layoffs in various industries.

Kelly Flynn of UBS Warburg figures revenues will rise to \$147 million in 2001. Hotjob's depressed valuation is too attractive to pass up, says Flynn. One source thinks Hotjobs will beat first-quarter estimates with a narrower loss and post earnings in the third and fourth quarters—rather than in the fourth quarter as analysts project.

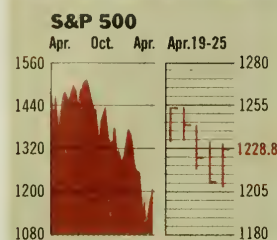
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BusinessWeek online

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Stocks



COMMENTARY

It was push and pull in the market this week. Rate cuts turned everyone giddy, until profit-taking on Apr. 20 sent stocks south. An Apr. 24 report showing a three-year low for consumer confidence didn't help. Next day, numbers from Walt Disney and AT&T and reports of record home sales topped Wall Street's forecasts. The result: a flat Dow, and Nasdaq and S&P fell less than 1%.

Data: Bloomberg Financial Markets
Bridge Information Systems, Inc.

U.S. MARKETS

	Apr. 25	Week	Year to date	Last 12 months
S&P 500	1228.8	-0.8	-6.9	-16.8
Dow Jones Industrials	10,625.2	0.1	-1.5	-4.5
Nasdaq Composite	2059.8	-0.9	-16.6	-44.5
S&P MidCap 400	494.2	0.5	-4.4	4.4
S&P SmallCap 600	214.5	1.3	-2.3	7.6
Wilshire 5000	11,284.1	-0.5	-7.3	-17.1

SECTORS

	Apr. 25	Week	Year to date	Last 12 months
BusinessWeek 50*	869.2	-0.9	-10.4	-31.3
BusinessWeek Info Tech 100**	485.7	-1.4	-14.1	-49.1
S&P/BARRA Growth	605.1	-0.8	-12.0	-31.4
S&P/BARRA Value	622.8	-0.8	-2.1	0.1
S&P Energy	949.8	3.8	1.9	12.1
S&P Financials	151.8	-2.1	-7.9	9.1
S&P REIT	86.3	0.0	-1.9	11.3
S&P Transportation	691.8	-3.9	-0.8	15.2
S&P Utilities	337.1	0.1	-3.9	26.3
GSTI Internet	135.4	-0.6	-25.4	-71.1
PSE Technology	744.7	-0.6	-8.6	-30.1

*Mar. 19, 1999=1000 **Feb. 7, 2000=1000

BEST-PERFORMING GROUPS

	Last month %	Last 12 months %
Engineering & Constr.	24.9	128.6
Entertainment	22.4	109.2
Aluminum	22.0	78.3
Steel	20.4	74.4
Electrical Equipment	17.9	69.1

EQUITY FUND CATEGORIES

4-week total return	%	52-week total return	%
Leaders		Leaders	
Precious Metals	7.7	Natural Resources	22.9
Natural Resources	4.8	Financial	20.3
Utilities	3.1	Real Estate	17.3
Small-cap Growth	3.1	Small-cap Value	15.8
Laggards		Laggards	
Latin America	-2.1	Technology	-46.1
Diversified Emerging Mkts.	0.0	Communications	-44.0
Japan	0.1	Japan	-35.7
Real Estate	0.1	Diversified Pacific/Asia	-30.6

EQUITY FUNDS

4-week total return	%	52-week total return	%
Leaders		Leaders	
Fidelity Select Software	15.0	Schroder Cap. Micro Cap	88.3
Fidelity Adv. Dev. Comms. T	12.3	Potomac Internet Short	81.5
Frontier Equity	12.1	CGM Focus	73.0
Roulston Emerging Growth	11.7	State St. Res. Glob. Res. A	67.2
Laggards		Laggards	
Rydex Dynamic Venture 100	-17.9	ProFunds UltraOTC Inv.	-85.4
ProFunds UltraShort OTC	-17.7	Jacob Internet	-78.3
Potomac Internet Short	-13.9	Potomac Internet Plus	-75.4
Firsthand Communications	-10.5	ING Internet A	-74.0

Data: Standard & Poor's

GLOBAL MARKETS

	Apr. 25	Week
S&P Euro Plus (U.S. Dollar)	1233.6	-0.7
London (FT-SE 100)	5827.5	-1.1
Paris (CAC 40)	5407.8	-1.8
Frankfurt (DAX)	6115.2	-0.8
Tokyo (NIKKEI 225)	13,827.5	1.4
Hong Kong (Hang Seng)	13,249.6	2.1
Toronto (TSE 300)	7945.3	-2.3
Mexico City (IPC)	5933.7	-3.4

FUNDAMENTALS

	Apr. 24	Wk
S&P 500 Dividend Yield	1.30%	1.30%
S&P 500 P/E Ratio (Trailing 12 mos.)	26.1	25.9
S&P 500 P/E Ratio (Next 12 mos.)*	21.3	20.8
First Call Earnings Surprise*	4.29%	2.1%

*First Call Corp.

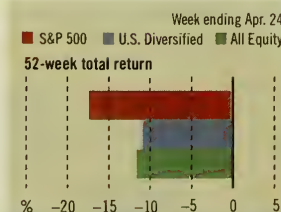
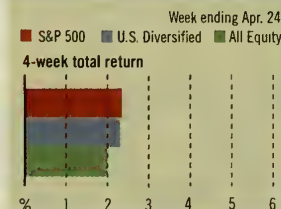
TECHNICAL INDICATORS

	Apr. 24	Wk
S&P 500 200-day average	1355.0	1360.0
Stocks above 200-day average	58.0%	57.0%
Options: Put/call ratio	0.62	0.61
Insiders: Vickers Sell/buy ratio	2.90	2.85

WORST-PERFORMING GROUPS

	Last month %	Last 12 months %
Cosmetics	-11.6	Communications
Communications Equip.	-10.8	Long-Dist. Teleco
Toys	-8.2	Instrumentation
Alcoholic Beverages	-7.4	Semiconductors
Household Products	-4.8	Metal & Glass Co

Mutual Funds



Data: Standard & Poor's

Interest Rates

KEY RATES

	Apr. 25	Week
MONEY MARKET FUNDS	4.73%	4.82%
90-DAY TREASURY BILLS	3.84	3.91
1-YEAR TREASURY BILLS	3.80	3.97
10-YEAR TREASURY NOTES	5.25	5.14
30-YEAR TREASURY BONDS	5.77	5.65
30-YEAR FIXED MORTGAGE†	7.07	7.22

†BancQuote, Inc.

BLOOMBERG MUNI YIELD EQUIVALENTS

Taxable equivalent yields on AAA-rated, tax-exempt bonds, assuming a 31% federal tax rate.

	10-yr. bond
GENERAL OBLIGATIONS	4.53%
TAXABLE EQUIVALENT	6.57
INSURED REVENUE BONDS	4.63
TAXABLE EQUIVALENT	6.71

THE WEEK AHEAD

PERSONAL INCOME Monday, Apr. 30, 8:30 a.m. EDT ► Personal income in March probably rose 0.4%, after increasing 0.4% in February. That is the median forecast of economists surveyed by Standard & Poor's MMS, a division of The McGraw-Hill Companies.

PURCHASING MANAGERS' INDEX Tuesday, May 1, 10 a.m. EDT ► The National Association of Purchasing Management's index is expected to have risen from 43.1% in March to 44.4% in April.

CONSTRUCTION SPENDING Tuesday, May 1, 10 a.m. EDT ► Building outlays for March likely increased by 0.3%. Lower interest rates and a strong housing market have helped keep new construction going. February spending rose 0.6%.

FACTORY INVENTORIES Wednesday, May 2, 10 a.m. EDT ► Manufacturing inventories in March probably rose minimally, if at all, after falling 0.1% in February. That is suggested by a small rise in March factory output.

BEIGE BOOK Wednesday, May 2, ► The Federal Reserve Board will release its compilation of regional economic activity. The Beige Book is made available in advance of the policy meeting scheduled for May 15.

EMPLOYMENT Friday, May 4, 8:30 a.m. EDT ► Nonfarm payrolls are expected to have added 50,000 jobs in April, after losing 86,000 in March. The April unemployment rate probably will fall to 4.4%, from 4.3% in March.

Oct.

Apr.

Daily: Apr. 19-25

Weekly

925
900
869.2
850
790

where fast. Down about 1% for the week, winners and losers were spread out across the board. Downside and downgrades sent Sun Microsystems down 13.6%. Semiconductor company Altera 0.2% after reports that Q1 earnings fell 16%. The energy sector propped up the index with COMECON Resources, Phillips Petroleum, and Occidental Petroleum in the plus column.

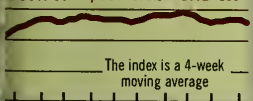
COMPANY PERFORMANCE

Company	% change		Rank	Company	% change	
	Week	Since 3/1/01			Week	Since 3/1/01
National	4.6	-4.7	26	Verizon Communications	3.6	13.9
Petroleum	0.4	5.2	27	Alza	1.1	16.5
	-1.7	20.3	28	Citigroup	-1.5	1.3
	0.4	20.5	29	Sun Microsystems	-13.6	-20.0
erials	0.3	17.3	30	Merck	-5.6	-6.1
inancial	2.2	1.5	31	El Paso	-0.9	-2.4
Petroleum	9.8	24.6	32	Altera	-10.2	1.3
	5.9	10.2	33	Marsh & McLennan	-3.9	-13.0
	2.5	12.2	34	Household International	2.2	10.9
	-3.7	-19.3	35	Chevron	2.0	9.8
thers Holdings	-4.5	5.7	36	SBC Communications	-2.3	-10.4
	4.3	-10.9	37	Mercury Interactive	2.5	2.3
	-6.7	-12.2	38	AOL Time Warner	1.0	12.5
iratories	-9.7	-14.2	39	Washington Mutual	-4.3	0.4
Financial	-5.0	-6.9	40	General Dynamics	3.2	8.4
nology	-9.8	18.9	41	Comcast	-1.1	-2.2
	0.3	11.2	42	Morgan Stanley Dean Witter	-8.2	-3.5
ess	1.9	18.9	43	Tellabs	-7.2	-26.7
y	2.6	10.7	44	Exxon Mobil	4.7	9.4
munications	-10.3	-32.2	45	Scientific-Atlanta	-1.1	22.3
Financial	-6.1	11.0	46	U.S. Bancorp	-4.9	-8.0
roleum	3.5	11.9	47	Paychex	-3.6	-7.4
ices	-0.9	9.0	48	Merrill Lynch	-5.3	4.5
ces	7.2	9.3	49	Bed Bath & Beyond	-1.3	14.7
alth	4.1	0.0	50	Texas Instruments	-3.0	8.2

Production Index

Change from last week: -0.5%
Change from last year: 5.3%

ALL OUTPUT Apr. 14=176.0 1992=100



Aug. 2000 Dec. 2000 Apr. 2001

Index declined again in the latest week. The index is a 4-week moving average, from 175.8 to 174. After seasonal adjustments, autos, lumber, and rail-freight traffic. Electric power was virtually unchanged. Gas and coal were higher for the week. Due to a data error, the index has been revised back to 175.8. To request the new data, please contact outlook@businessweek.com

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BusinessWeek (ISSN 0007-7135) published weekly, except for one week in January August, by The McGraw-Hill Companies, Inc. Executive, Editorial, Circulation, and Advertising: 1221 Avenue of the Americas, New York, N.Y. 10020. U.S. subscriber rate \$54.95/year; C \$69/year. Periodicals postage paid at New York, N.Y., and at additional mailing offices. Postmaster: Send address changes to BusinessWeek, P.O. Box 430, Hightstown, NJ 08520.



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A MANDATE FOR CHANGE IN JAPAN

The choice of Junichiro Koizumi as Japan's Prime Minister and president of the ruling Liberal Democrat Party demonstrates that a "soft" revolution is under way in Japan, not unlike those in the Soviet Union in the 1980s and Mexico in the 1990s. Given their first chance at democratically choosing a party leader, LDP members opted for a reformer who is challenging the political and economic status quo. Conservative, statist forces in the LDP will resist. Protected, subsidized industries will drag their heels. But after a decade of economic stagnation, the Japanese are increasingly demanding an end to top-down, state-directed economic policies. They want more open politics and a more entrepreneurial, market-based economy. This is a key moment for Japan. Failure to reform and continued economic stagnation could open the door to extreme nationalist forces that are surprisingly strong in Japan.

The big question is whether Koizumi can deliver change. He certainly is suggesting policies that would radically transform Japan (page 96). He wants to privatize Japan's \$2 trillion postal savings system—the honey pot of politicians and bureaucrats. Koizumi ran the postal system in the 1980s and knows how LDP politicians use it to finance public-works projects and farm subsidies. Construction and real estate companies, as well as farm co-ops, return the favor by contributing heavily to the LDP election campaigns. An astonishing one in six Japanese workers is employed in construction, and the LDP gets their votes, as well as those in the countryside. In a gerrymandered electoral system, this keeps the LDP in power. Urban consumers get little except high sales and income taxes, which also go to subsidizing special economic interests. That's why they prefer Koizumi.

The new Prime Minister also wants the banks to get on with the job of writing off bad corporate debt still on their books, an endless task that has ground on for more than 10 years. He in-

herits the latest in a series of ill-formed bank bailout plans from his predecessor. He should dump it in favor of a tougher program to mandate write-offs by 2003, tougher rules on closing nonperforming loans and forcing banks to seize collateral from deadbeat borrowers. This, of course, could send unemployment much higher. Koizumi is proposing to shore up unemployment benefits to ease workers' pain. He is trying to ease some of the safety-net burden from corporations to the government. Finally, he wants to cap runaway deficit spending, which has given Japan the highest debt levels of any industrial nation.

Time is running out for Japan. Its corporations are pulling back on investment. By cutting costs, they are lowering wages and becoming more competitive. But they are putting most savings into safe government bonds rather than into new capital investments. Right now, companies see few investment opportunities and no need to expand capacity. Without investment, there is little growth. It's a vicious cycle.

The LDP is a ruling party with less and less legitimacy in Japan. It hasn't won an election in a city of 2 million in more than 20 years. When voters are given a real chance, as they were with Koizumi, they opt for reformers. In recent elections, they elected many independents in the regional prefectural elections and Tokyo itself. Frustrated urban Japanese have been waiting for reform for a decade, with little effect.

Koizumi could change that. He must now form a Cabinet and prepare for July elections for the Upper House. If the LDP conservatives try to block him, they can check his progress on a soft revolution—for the moment. The status quo cannot continue indefinitely. Economic stagnation has become a debilitating force inside Japan, tearing apart the nation's social fabric and political consensus. The U.S. needs a stable Japan. Koizumi's reforms represent the best path forward for Japan and the global economy.

BUSH: THE NEXT 100 DAYS MAY BE TOUGHER

Let's give President Bush credit. In his first 100 days, he clearly beat expectations on two key fronts—taxes and foreign policy. Few expected a \$1.6 trillion tax cut to have a chance in a closely divided Congress, but it looks like Bush will get most of it, and quickly. Few expected a sophisticated foreign policy after a campaign filled with cold-war-style rhetoric, but Bush's deft handling of the spy-plane crisis with China and his shrewd handling of arms sales to Taiwan were two performances that the Council on Foreign Relations could applaud. The second 100 days may prove more problematic.

In focusing on tax cuts as the key piece of domestic legislation, Bush has jettisoned his promise for bipartisanship in Washington. To build support on taxes, he has moved hard to the right on domestic social issues. He has consulted little with Democrats or moderate Republicans, hurting chances of

progress on a patients' bill of rights, Medicare, and Social Security reform and trade. Indeed, it is difficult to see how President Bush can deliver on his free-trade promises in Quebec without some compromise on the difficult problem of intellectual property and environment issues in trade pacts.

One great surprise in the first 100 days is how polarized this Administration can be. Early decisions on global warming, oil drilling in the Arctic, carbon dioxide, and arsenic rain are hacksles of independent suburban voters who were surprised by Bush's anti-environment positions. Bush is now tacking toward the center on the issue, moderating his extremism and seeking independent support for the 2002 congressional elections.

The same flexibility and willingness to move away from extreme positions and shift to the center could get a lot of important legislation passed in the 100 days ahead.

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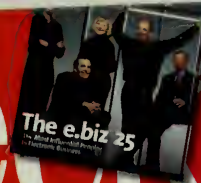
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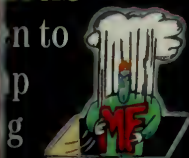
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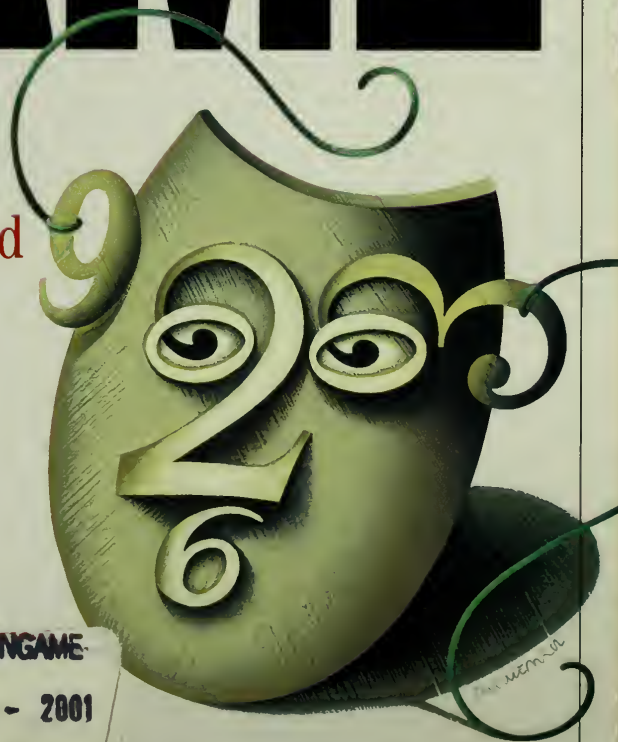
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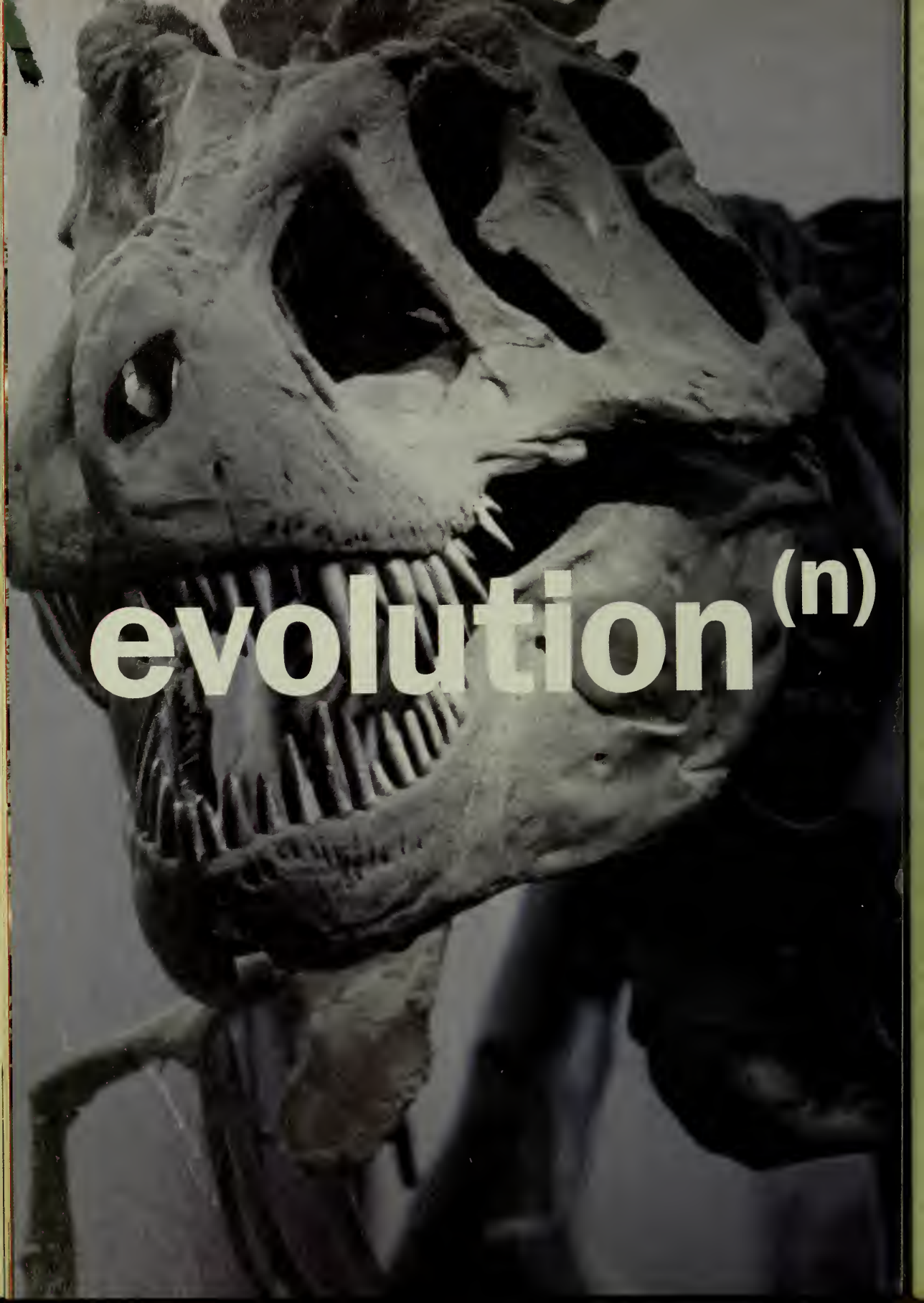


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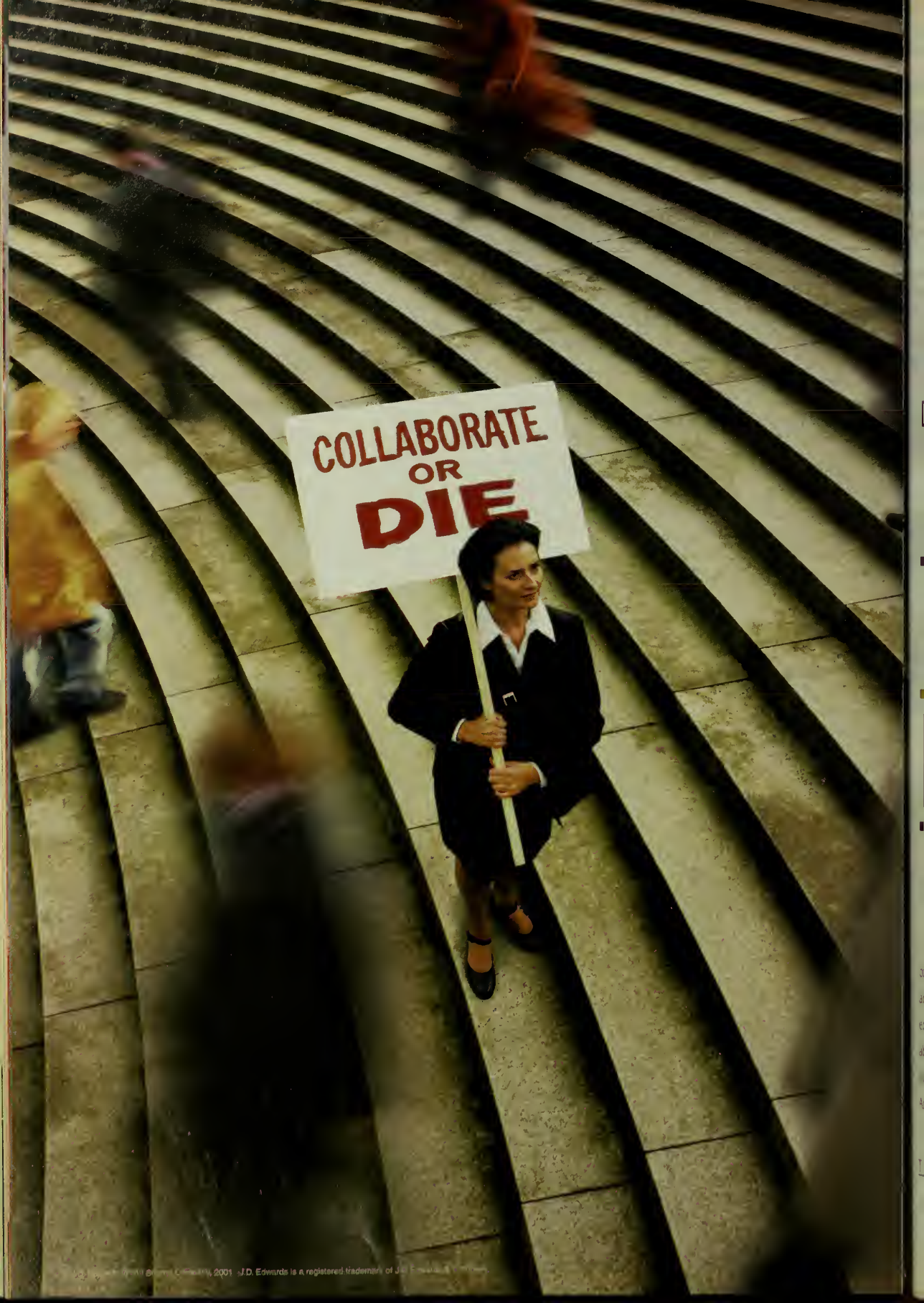
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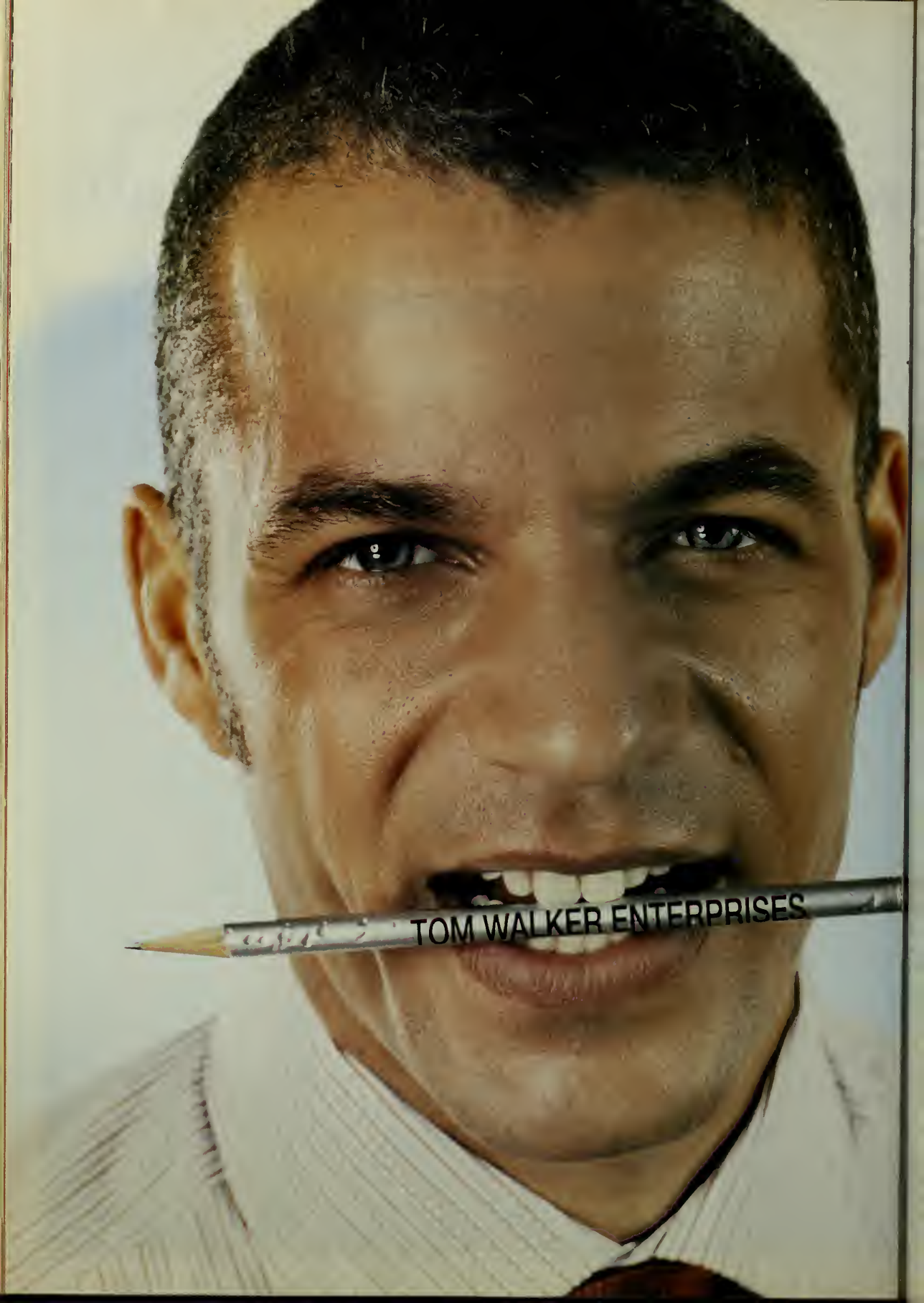


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COVER STORY

NUMBERS GAME

When companies put results in the best light, investors may be in the dark page 100

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The BusinessWeek



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Digital Director

Though *Star Wars* boss George Lucas says it's not his goal, he admits that new technology could cut Hollywood out of the picture



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"In today's market doing nothing could be risky."

[Commentary on today's market.]

by Charles R. Schwab

Some of your investments probably got hit hard recently. High tech, overseas, the Dow, it hasn't been pretty.

But I believe

did as will this one.

Now, can I or the Schwab analysts with all their facts and figures tell you when that will happen?

Absolutely not. We're not magicians.

All I can promise is that, yes, as long as history repeats itself, there will be an end to this downturn. Twelve previous times, when all

was said and done, stocks have typically outperformed other types of investments.

It's a pretty solid chance this time around will be the same.

After all, history is on our side.

THE IMPORTANCE OF DIVERSIFICATION.

If you went a little overboard on technology stocks like many others did, you may have just received a solid lesson in the need for portfolio diversification.

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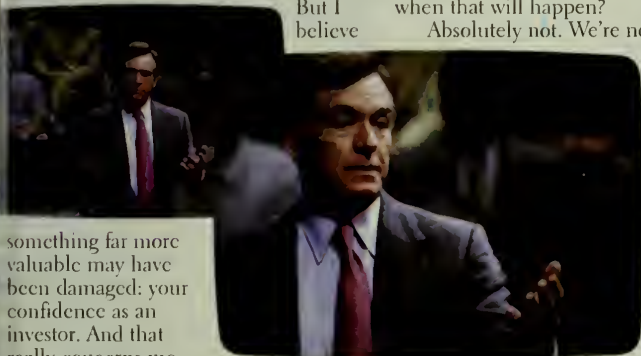
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something far more valuable may have been damaged: your confidence as an investor. And that really concerns me.

So I want you to take a deep breath, relax, and read a few things I've learned over forty years in the investment business.

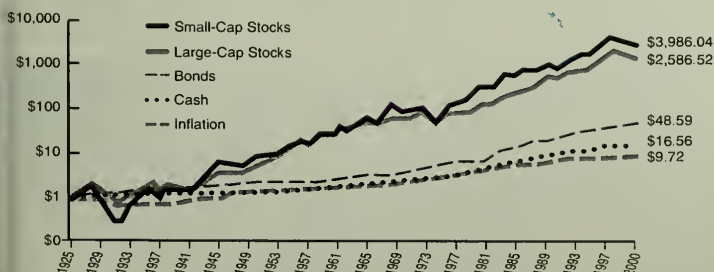
WILL THIS DOWNTURN EVER END?

Yes, obviously we have been experiencing a market correction. But no, I don't believe it will go on forever.

Why do I think this? In my years as an investor I've seen twelve such drops, including this one.

The Schwab Center for Investment Research® tracks and analyzes market moves like this and uses the past to provide perspective on the future.

We can tell you that some drops only lasted a matter of months, and a few took years to end, but end they all



The chart above illustrates the growth in value of \$1.00 invested in various financial instruments from 1925 through 2000. Figures above indicate the value of that same \$1.00 at the end of 2000. Note: Results assume reinvestment of dividends on stocks and coupons on bonds, and no taxes or transaction costs. Generally, small-cap stocks are in the bottom 50% of publicly traded companies based on market capitalization. These stocks are subject to greater volatility. Source: Stocks, Bonds, Bills & Inflation 2001 Yearbook. © 2001 Ibbotson Associates, Inc. Based on the copyrighted works by Ibbotson and Sinquefeld. All rights reserved. Used with permission. The indices representing each asset class are S&P 500 Index (large-cap stocks), CRSP 6-10 Index (small-cap stocks), Ibbotson Intermediate U.S. Government Bond Index (bonds), and 30-day Treasury bills (cash). Indices are unmanaged, do not incur fees or expenses and cannot be invested in directly. Past performance is no guarantee of future results. Schwab Center for Investment Research is a division of Charles Schwab & Co., Inc. © 2001 Charles Schwab & Co., Inc. All rights reserved. Member SIPC/NYSE (0301-13190).

Up Front

EDITED BY SHERIDAN PRASSO

THE FUDGE FACTOR

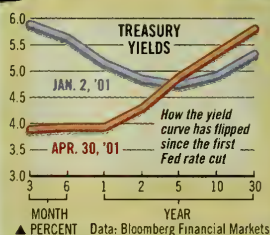
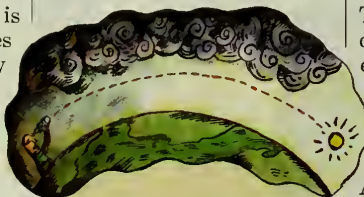
ARE WE SEEING THE ECONOMY STRAIGHT?

ECONOMISTS AND INVESTORS always look for the crystal ball that can predict the next recession or recovery. But indicators go in and out of fashion like children's toys, and what Wall Street is playing with these days is the yield curve. It measures interest rates on Treasury bills and bonds. And it's flipped upward in the direction of economic recovery, suggesting "we're getting to the end" of the downturn, says David Wyss, chief economist at Standard & Poor's DRI.

But based on recent history, it may not be a good idea to trust it. While the curve was a great forecaster back in the '60s, '70s and '80s, it has wrongly indicated the health of the U.S. economy

several times since then. Ahead of the 1990 recession, the curve indicated the economy should be growing. Instead, it declined. The curve was also unreliable in predicting the great '90s boom.

So why use it? Says Monika Piazzesi, finance professor at UCLA: "It's not a sure bet, but it's the best forecaster we have." *Charles J. Whalen*



GRAPE EXPECTATIONS

ANOTHER VINEYARD ON THE BARBIE

REALLY ENJOYED YOUR LAST Australian Shiraz? Why not buy a winery Down Under

and line up a steady supply? With the Aussie dollar down to around 50¢ U.S., only pennies above its all-time low in April, Australia is running a half-off sale. And a bunch of Australian wineries are ripe for the picking.

With good reason: Australian wine is in a class with French and Californian, and the country is on its way to becoming the

world's fastest-growing wine exporter by volume. Exports grow 30% annually, and revenue growth averages 20%.

With that in mind, California vintner Kendall-Jackson has been in talks about linking with BRL Hardy, one of Australia's largest wineries. And Robert Mondavi has formed a joint venture with Australia's Rosemount Estates which in February merged with

TALK SHOW "Experts say gas may go to \$3 per gallon this summer. So your SUV will stand for 'standing utility vehicle.'"

—Jay Leno, *The Tonight Show*

HALLS OF IVY

PROFESSOR GORE MAKES THE GRADE

AL GORE MAY NOT have been able to drive home the Presidency, but he's become a pro as a college professor this term. When not teaching civics back in his home state, Tennessee, he was drawing star power to his class at



GORE AND MURDOCH

Columbia University's Graduate School of Journalism.

News Corp. Chairman Rupert Murdoch, Fed Chair Alan Greenspan, and *Late Show* host David Letterman all appeared before Professor Gore's class of aspiring scribes. Once a reporter himself, Gore instigated debates about media credibility and conflicts with corporate interests.

Greenspan, talking about financial journalism's impact on markets, explained why

he holds so much press conferences: His testimony before Congress is good substitute because members of Congress "ask better questions," he says. Murdoch, discussing how corporate owners

shapes news, said newspapers have a responsibility to take strong stances on issues.

Students were surprised Gore's teaching abilities charmed by his humor. "I'm funny, personable, and so deprecating," says graduate student Lenora Chu, "not at all the way the media portray him." Gore held his last class on May 2, but Columbia officials say they have not discussed having him back next fall. *Brian P. Murphy*

local vintner Southcorp to become the largest premium wine company in the world. Euros are flocking Down Under, too: LVMH Moët-Hennessy Louis Vuitton in January acquired small winery Mount Adam. Britain's Diageo also has been scouting around.

Australia's vineyards are a steal compared with those in California's Napa and Sonoma counties, where prices run \$64,800 to \$101,200 per acre. Vineyards in

South Australia's Barossa Valley, where family-owned Arenberg still uses 19th-century presses for its award-winning reds, cost a mere \$13,400 to \$20,200 per acre, according to Salomon Smith Barney. That's put Australia "on the radar" of international investors, says Allan Hung of Tower Asset Management in Sydney.

Better act quick: Aussie dollar won't stay in cellar forever. *Becky Gayer*

THE LIST WHERE SMALLER IS BETTER

Frequent fliers and travel pros rank small airlines first among domestic airlines. Of the biggies, only United, Continental, and Delta made the top 10. Here are the airlines, their hubs, and respondents' comments:

1 MIDWEST EXPRESS Milwaukee Wide seats, free champagne, warm cookies	2 JETBLUE New York Innovative discounts, roomy seats with personal DirecTV	3 ALASKA AIRLINES Seattle Well-managed, a great value	4 MIDWAY Durham, N.C. Lots of leg room, caring staff	5 NATIONAL Las Vegas Easy, nonstop flights, service is anxious to please
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*Survey of 31,500 fliers rating 70 airlines

Data: Zagat Survey



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Up Front

HERE TODAY...

WHERE HAVE ALL THE PAY PHONES GONE?

BAD NEWS FOR CELL PHONE holdouts trying to rely on the nation's pay phones: They're rapidly becoming an endangered species. Some 15% of U.S. pay phones have disap-



UNPROFITABLE: Blame cell phones

peared in the last few years, bringing the ratio of phone-per-person to 1:130 down from 1:108. Thousands more will be zapped this year: 16,500 by Verizon and Sprint

AS THE DOWNTURN TURNS

THE GOLF INDUSTRY IS getting an unexpected boon from layoffs. Web sites listing golf jobs (resort superintendent, \$100,000; apparel sales director \$60,000, etc.) are finding their pool of candidates bolstered by the nationwide jump in job-seekers. Since its launch six months ago, golf-surf.com has registered 12,500 users, seen its résumé bank grow to 1,700 and filled 25 jobs. Says Miami-based CEO Michael Schlesinger: "It's amazing the quality of people we're getting from the failed dot-coms or even the blue-chip companies." *Joan Oleck*

alone. And BellSouth is abandoning the pay phone biz—leaving independents to take over or just taking out its 420,000 phones altogether.

The reason? Pay phones don't pay off. Calls are down 23% since 1998, the result of competition from cell phones. And revenues are expected to fall 2.4% this year—compounding declines of 5.3% last year and 6.4% the year before. While a phone generates \$150 to \$200 a month, repairs can cost up to \$800, obliterating profits.

But most damaging are long-distance resellers (go-betweens often beginning with 10-10). Some don't reimburse pay-phone operators for making the connections. That can eat up half of revenues, says Vincent Sandusky of the American Public Communications Council, which represents independent pay phone owners who control a quarter of the business. "We've got a lot of companies in trouble," he says. An Apr. 5 Federal Communications Commission ruling that clarifies who pays whom may help.

It's the poor and isolated who are most affected by pay phone decline. Already on the Cherokee Indian Eastern Reservation in North Carolina, Verizon has disconnected 15% of its pay phones since October. "Many of our members are too poor to afford their own phones," says Chief Leon Jones. Wisconsin and California are the only states using surtaxes to subsidize money-losing phone service.

Adds Ted Weerts, executive director of the Travelers Aid Society in Philadelphia, soon there'll be "no way for many poor people to call their employers, doctors, children's schools." Unless somebody starts handing out cell phones that cost 35¢. *Ann Therese Palmer*

DRAWN & QUARTERED



PRODUCT PEEK

HOW TO JUMP THE LINE AT THE MOVIES

LOOKING FOR A WAY AROUND Mr. Moviefone's annoying voice while still reserving movie tickets in advance? Moviegoers at Marcus Theatres, which operates 482 screens in the Midwest, can now pay for their tickets online using a credit card. (The 75¢ service charge is half of AOL Moviefone's.) But unlike phone or other e-ticket reservations that require in-person pickup, this one allows tickets to be printed out on a home or office printer. No waiting in line. Go right in.

National Amusements and Muvico, which together own 1,600 screens, soon will offer e-tickets after tests in Florida and Massachusetts. A bar code, scanned at the entrance,

prevents counterfeiting. Predicts Bruce Olson, Marc president: "This is going revolutionize the way we buy movie tickets."

Ultimately, e-tickets save theaters serious money by reducing staff at the



office. Currently, the average staff-per-customer cost is hefty 50¢, says Olson. If only cybersolutions could shorten the soda and popcorn lines. *Ann Therese Palmer*

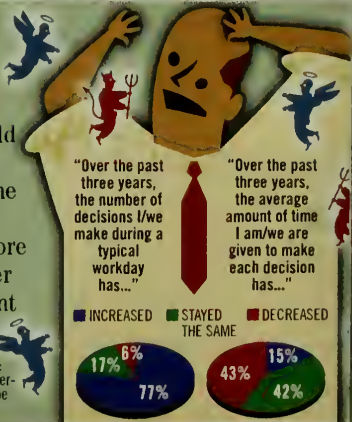
THE BIG PICTURE

'HURRY UP AND DECIDE!'

Bad decisions in the corporate world can cost millions. Yet managers in the Digital Age report having to make more decisions than ever in the same amount of time or less.

POLL OF 479 MANAGERS FROM VARIOUS MEDIUM AND LARGE COMPANIES

Data: Kepner-Tregoe



FOOTNOTES Polled executives who expect to invest more in stocks than they did last year: 41%; invest less than last year, 9%

we generate who says!



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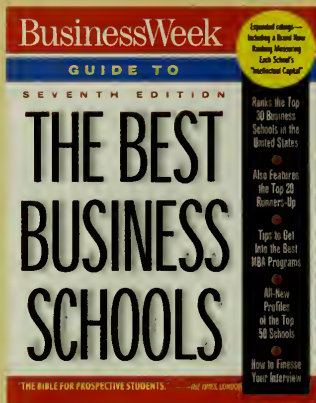
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Stephen B. Shepard

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MAY 14, 2001 (ISSN 0007-7135) *** 3732
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 Executive, Editorial, Circulation, and Advertising Offices: The McGraw-Hill Companies Building, 1221 Avenue of the Americas, New York, N.Y. 10020. Telephone: 212-512-2000. Telex: Domestic 127039; Int'l. 2294127039. U.S. subscription rate \$54.95 per year; 2 years, \$79.95; 3 years, \$99.95. Single copies/back issues, \$9.95. Call 1-800-288-9807 or email:business@mcgraw.com. Subscriber Services: 1-800-635-1200. TDD: 1-800-554-1579.
 Postmaster: Send address changes to *BusinessWeek*, P.O. Box 430, Hightstown, N.J. 08520. Periodicals postage paid at Montreal, P.Q., Canada Post International Publications Mail Product Sales Agreement No. 246343.

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IT'S TO BLAME FOR TELECOM MELTDOWN?

The "Telecom meltdown" (Special Report, Apr. 23) is the result of a "crowd-effect," which occurs when a market opportunity is chased by too many players all making the same investments and hope that the first or the biggest will get it all. Business history is full of examples of how crowding destroys value. Telecom managers should be held accountable for the excessive risks that they have undertaken at the expense of their stakeholders.

Rado Kotorov
Morristown, N.J.

In the coming months, the Federal Communications Commission will face a series of rulings that will determine whether we will have a competitive market for voice and data, as well as broadband services. Pro-competition decisions will mean lower prices, faster innovation, greater economic growth, and continued U.S. leadership in high-tech. Decisions that favor continued monopoly will mean the opposite. Unfortunately, recent signs from Washington are not been encouraging.

Regina M. Keeney
Washington

HOW TO KEEP NUCLEAR PLANTS HUMMING

Nuclear power plants can make a real difference in the next 5 to 20 years ("A comeback for nukes?" News: Analysis & Commentary, Apr. 23). The new pebble-bed reactors now under development are extensions of previously developed gas-cooled reactor technology, and they would be inherently safe and compact to build in modular sizes. Placing these at sites with existing nuclear plants would avoid many of the not-in-backyard issues we face when trying to site anything these days. Communities that already host nuclear plants are naturally supportive of the technology, and in their intimate experience with it.

Robert Boyden Lamb
New York

Your story includes a picture of cooling towers glowing in the dark. It would be the article more accurate, for us engineers at least, to show a reactor building instead. Cooling towers, though not as ominous-looking, employ a quite conventional technology that uses the atmosphere as a heat sink, involving no nuclear technology at all. In fact, many nuclear power stations that use rivers

or lakes as heat sinks do not have such cooling towers, and gas- or coal-fired stations may actually use them, too.

Jorge Lepre
Hastings-on-Hudson, N.Y.

Exelon Corp.'s rosy attitude toward nuclear power certainly appears to be ignoring the lessons of history ("Safe enough for your backyard?" News: Analysis & Commentary, Apr. 23). It has been known for over 50 years that a solution must be found for the disposal of radioactive waste. And over 30 years ago, it was concluded that small nuclear plants would not be economically viable.

William L. R. Rice
Locust Grove, Va.

Exelon's boss, John W. Rowe, had better realize there is more to life than making profits. His comment "I'm into whatever makes more money for shareholders" is not something that long-lasting companies ever talk about. Exelon will not be around for very long if he keeps expressing his thoughts like this.

Ryan Wodele
St. Paul, Minn.

IF THE GREEN CARROT WORKS, WHO NEEDS THE STICK?

Paul Raeburn does an excellent job of ferreting out corporations that have found it advantageous to keep a clean environment ("Global warming: Look who disagrees with Bush," Science & Technology, Apr. 23). He still misses an obvious point: If it is economically desirable to be green, where is the need for government intervention?

Bruce Hansen
Orem, Utah

TREAT INTERNET INFO JUST LIKE CREDIT-CARD DATA

As is the case with credit-card providers, Internet companies should be placed legally and morally in a position where they must go to their customers with notification of changes in the users' legal rights ("Your right to privacy: Going...going...", News: Analysis & Commentary, Apr. 23).

William Beck
Chappaqua, N.Y.

BACK TO THE DRAWING TABLE FOR THESE COMPUTERS

One drawback I see to the new portable computers is their name ("Is the world finally ready for tablets?" News: Analysis & Commentary, Apr. 9).

CORRECTIONS & CLARIFICATIONS

The Ericsson story, "In need of a recharge" (International Business, May 7), said that Nokia has \$3.8 billion in vendor financing agreements. Of that, \$2.7 billion represents commitments for loans that have not yet been made.

The List (Up Front, Apr. 30), which described radio-frequency identification-technology applications, misidentified a company working with McDonald's Corp. on an e-pay system. Its correct name is FreedomPay.

"Tablet" brings to mind images of a pill that is hard to swallow. Microsoft Corp. and its partners could start by using this device to jot down new ideas.

Valaya Gaudet
San Jose, Calif.

A NEW SOURCE OF COLLEGE FUNDS? I'LL BUY THAT

I am a parent of two young children who hasn't got a clue how to save enough money for the both of them to go to college ("Spending your kids into college," Social Issues, Apr. 23). I have three words for Upromise Inc.: Sign me up.

Kevin Cieri
Long Branch, N.J.

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EQUATION
 $T = K \sum_i \frac{1}{\mu_i R_i}$
 PACKED
 FOR
 $\frac{1}{\mu_i C_i} + \frac{1}{\mu_i R_i}$
 REPRESENT
 $(\lambda_i / \mu_i C_i)$
 AT THE
 THE APP
 THE AR
 IS
 NS
 20

PROCEDURE YIELDS THE FOLLOWING EQUATION FOR
 CAPACITY

$$T = \frac{1}{\mu} + \left(\frac{D_0}{\mu} \right) \frac{\sum_i \sqrt{\lambda_i d_i}}{\sum_i \sqrt{\lambda_i d_i}} \quad (12)$$

$$D_0 - \sum_i \frac{\lambda_i d_i}{\mu} > 0 \quad (13)$$

IF WE SUBSTITUTE THIS RESULT BACK INTO THE EQ
 WE OBTAIN THAT THE PERFORMANCE MEAS
 A CHANNEL CAPACITY ASSIGNM

$$T = \frac{\bar{n} (\sum_i \sqrt{\lambda_i d_i})}{\mu}$$

WHERE

$$\bar{n} = \frac{\sum_i \lambda_i}{\gamma} \quad \text{CHANNEL LENGTH (15)}$$

THE RESULT IS REFERRED TO AS THE
 SQUARE CAPACITY ASSIGNMENT; THIS
 PARTIC FIRST PROVIDES TO EACH
 ON EQUAL TO λ_i / μ WHICH IS MERELY
 RATE WHICH MUST PASS OVER THAT
 WHICH IT MUST OBVIOUSLY BE PROVIDED

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EVOLUTION'S WORKSHOP

God and Science on the Galápagos Islands

By Edward J. Larson

Basic Books • 320pp • \$27.50

WALKING IN DARWIN'S FOOTSTEPS

On Jan. 16, the oil tanker Jessica ran aground in the bay of Puer to Baquerizo Moreno near San Cristóbal, one of the Galápagos Islands. During the next few days, 200,000 gallons of oil poured out of the tanker, forming a slick that covered more than 700 square miles.

The spill threatened one of the world's preeminent natural laboratories—one that holds a special place in Western thought. This stony, forbidding archipelago, 500 miles off the coast of Ecuador, was the inspiration for Charles Darwin's theory of evolution. The islands' flightless cormorants, swimming iguanas, giant tortoises, and surprising variety of finches fascinated and puzzled Darwin when he arrived in 1835 aboard the H.M.S. Beagle. He spent years trying to understand what he had seen there before formulating his ideas about natural selection and the origin of species. But it was in the Galápagos that he first began to ask the right questions.

Before the Jessica's oil could do serious damage to the Galápagos, most of it drifted out to sea, averting what would have been an ecological and scientific disaster. The Galápagos Islands are more than a museum; they remain an important laboratory for the study of evolution. Researchers from around the world visit them to produce studies that extend Darwin's observations and fuel the continuing debate between evolutionists and creationists about the origin of life. And the lingering romance associated with Darwin's trip draws 50,000 tourists a year.

Evolution's Workshop by Edward J. Larson, a historian of science at the University of Georgia, is a book those visitors will want to take with them. It provides a fascinating narrative of the explorers, buccaneers, and socialites who have visited the islands. It tells of the

scientists who followed in Darwin's footsteps—and Larson nicely summarizes the history of evolutionary biology and some of the current scientific debates. The volume also reports on efforts to protect the islands as nature reserves.

Larson fails, however, to deliver on the promise of the book's subtitle and its opening chapters, which suggest that he will explore the protracted debate between scientists and some Christians about the creation of the world and the origin of species. He writes that Darwin's case for a natural origin of species "directly challenged traditional notions of purpose and meaning in life, and escalated the culture wars that pitted science against religion, and reason against revelation." But Larson tells us little about where those culture wars stand today.

Much of *Evolution's Workshop* is devoted to the many travelers who have visited the Galápagos during the past 500 years. Europeans were originally lured to the area in the early 16th century by the discovery of Inca gold in Peru. The first to visit the islands was Fray Thomas de Berlanga, the Bishop of Panama, who arrived there in 1532 while on a mission to investigate the battles among conquistadors and the killings of Peruvians. Like many who followed him, he found the islands utterly uninhabitable. Two of his sailors and 10 horses died before he made it back to the South American mainland.

Other visitors, carried on swift and unpredictable currents, arrived by accident—and not all of them survived. During the 16th and 17th centuries, buccaneers used the islands as an outpost as they plundered the South American coast. In the wake of Darwin's visit,

many other naturalists visited the Galápagos, and American socialites, including Vincent Astor and William Vanderbilt, began to make the trip in the 1920s.

One of the most famous to pay a visit was Herman Melville, who arrived 70 years after Darwin and whose view of the islands wasn't much different from Darwin's. Melville called them "an enchanted ground" and found them "inhabited by an innumerable host of fiends, ant-eaters, man-haters, and mandrills."

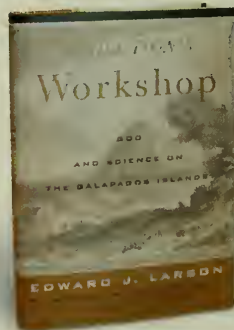
The first section of *Evolution's Workshop* discusses the creationist notion of the origin of life in the centuries between Christopher Columbus and Darwin. Larson makes the fascinating point that Columbus' discovery of exotic animals in the New World triggered a crisis among European theologians: If the New World was populated with animals that didn't exist in the old, then God must have created them after the flood. If that were true, however,

creation would have taken more than six days. Theologians came up with this solution: If the New World animals existed before the flood, then they must have been on Noah's Ark. Some spread to the New World and prospered, while those that remained in Europe must have died out. "This became a Church-approved answer," Larson writes, "but it stretched credibility even then."

At that time, nature study was as worthy an occupation because it revealed the grandeur of God's creation (Darwin himself was studying to become a clergyman when he traveled to the Galápagos.) Darwin's science was unpeachable, but it was shrouded in a particular set of religious beliefs. The question that Larson does not answer is: What belief system governs today's science? Many of today's naturalists treat their data into a quasi-religious moral tale that condemns modern civilization as a destroyer of wilderness. Larson surely has a lot to say on that subject. It's a shame that he didn't share it with his readers.

BY PAUL RAE

Senior Writer Raeburn covers science and the environment.



LARSON FAILS TO BRING THE DEBATE BETWEEN CREATIONISTS AND EVOLUTIONISTS UP TO DATE

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BY STEPHEN H. WILDSTROM

tech&you@businessweek.com

SONY'S HANDHELD GETS BEST OF BREED



Greater resolution and a built-in MP3 player are two things that set CLIE apart

Sony Electronics has a well-earned reputation for persistence. The company's first entry into a new field often isn't very good. But, as it has shown with laptops, Sony will keep trying until it gets it right.

The latest evidence is the new Sony CLIE, a handheld based on Palm software. The first CLIEs, introduced last year, were so-so Palm clones. The color version featured a dim screen that was panned so loudly by reviewers that Sony never marketed it outside of Japan. But the newest version of the CLIE, which costs \$500 and is just a bit narrower, longer, and thicker than a Palm V, is a breakthrough for Sony. Despite reservations about a Memory Stick expansion slot, I think it is the best color Palm device available, superior to both the Handspring Visor Prism and the new Palm m505.

One interesting feature of the CLIE is a built-in MP3 music player, a first for any Palm device. But the real reason for my enthusiasm is that Sony has transcended the single greatest weakness of the Palm design. Going back to the original 1996 PalmPilot, every display has featured 160x160 pixels. This produces coarse, grainy screens that do a mediocre job displaying text and are pretty much hopeless for graphics. Palm promises higher-resolution displays, but not until it releases version 5.0, at some unspecified date.

Sony decided not to wait. It did some tweaking to make the Palm software work with a 320x320 pixel color display. This has two benefits. First, there are four times as many pixels, quadrupling the amount of information you can fit on a screen. Second, each pixel is one-fourth the size, yielding a much sharper-looking screen.

Since most existing Palm applications assume a 160x160 screen, they look as bad as ever on the CLIE. But Sony rewrote the system software, as well as the Address Book and Date Book applications, for the new screen. The biggest difference is the appearance of text: Characters use thinner strokes and lack the jaggedness of the Palm fonts. The result is both nicer to look at and considerably more legible.

PHOTO FRIENDLY. Sony bundles some applications that show the new screen to good advantage. PictureGear Pocket displays quite creditable photos, while gMovie will show a short video at about five frames per second. One limitation actually made worse by the higher-resolution screen is that the CLIE is short on pro-

cessing power, especially compared with handhelds using Microsoft's PocketPC software. Palm is moving to support faster processors, but this many months away.

The CLIE introduces yet another expansion method into the Palm world. Handspring's Springboard slot is proprietary, but a lineup of cameras, music players, and other devices to use it make it powerful and flexible. The SD card slot in the newest Palms is more limited, but at least it's based on an industry standard. Sony's Memory Stick is the worst of both worlds—proprietary and limited. Only storage cards are currently available for it, about \$60 for 32 MB, \$110 for 64 MB. Things will get more interesting later this year when Sierra Wireless brings out a wireless modem based on CLIE's memory stick. **SCROLL WHEEL.** Meanwhile, the most interesting use of the Memory Stick is to store music for the CLIE's built-in MP3 player. Sony has mercifully abandoned a plan, used in some of its music players, to require that music be stored on the Memory Stick only in a special format that prevents additional copies from being made. The new version should make things easier for consumers, but unfortunately, the software was not available in time for testing. One thing is certain:



To use the music player, you'll need a lot more memory than the 8 megabyte Memory Stick that comes with the CLIE. That will only give you about 15 minutes of medium-quality music, though it should allow about an hour's worth of storage using the built-in voice recorder.

Overall, the CLIE is an attractive design, well thought out. The fact that it is slightly narrower than any Palm or even the new Handspring Visor Edge should endear it to anyone with smaller hands. And a scroll wheel and back button that takes you to the last screen viewed encourage one-handed operation. As much as I wish that all Palm device makers could standardize on an expansion feature, the CLIE is a welcome addition to the Palm OS family.

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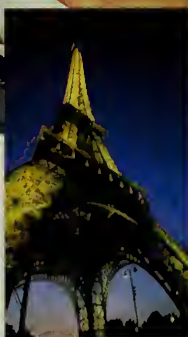
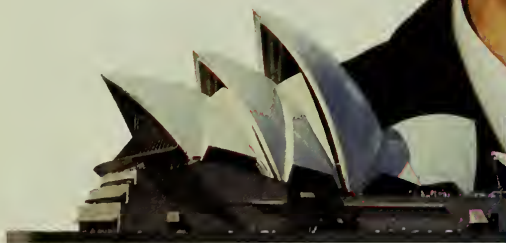
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*Source: IDC, December 1999. *Who Will be Leading the Global IT Services Industry in 2000?* A Competitive Analysis by Mauro Peres, Sophie Janne Mayo

BY JEFFREY E. GARTEN

WHAT BUSINESS SHOULD BE TELLING THE PRESIDENT



MYOPIA:
Bush's
adversarial
foreign
policy could
poison key
relationships.
CEOs with
global
experience
ought to
be setting
him straight

At a time of brutal global competition and no prospect of a major war, you'd think American foreign policy would be highly supportive of business interests. Think again, for the Bush Administration and CEOs of U.S. multinationals seem to be living in two incompatible worlds.

In the commercial universe, most of America's largest companies earn over a third of their revenues abroad. They are not just our primary exporters but also our major importers and are deeply integrated into global networks for finance, information, and supplies. About \$1.6 trillion of foreign exchange changes hands every day. Management teams and workforces are multinational, and companies have made alliances with foreign companies, governments, and universities. The nightmare of CEOs is that bitter confrontations will disrupt the momentum for more open borders.

The Bush team appears to inhabit another planet. Among the few policies reflecting an understanding of an interconnected world has been its push for freer trade in the Americas. Otherwise, the Administration's foreign policy risks poisoning key relationships. It aggravated most major governments with its plan to build a national missile shield. It insulted European officials by deep-sixing the Kyoto accords on global warming. It humiliated the South Korean leadership by distancing itself from Seoul's peace efforts with Pyongyang. Although it has since been sensibly cautious in securing the return of the spy plane crew, the Administration early on needlessly chilled relations with China by branding it a "strategic competitor." And it called Moscow an "active proliferator" before broader policies toward Russia were in place.

In a world in which politics, economics, and social issues are so intertwined, America's go-it-alone machismo is sowing the seeds for a backlash from the very countries whose cooperation we will need on a host of global economic issues. That's why I'd like to see some of America's top business leaders request a private meeting with President Bush to express concern about the dangerous drift of his foreign policy. Among those present should be General Electric Chairman and CEO Jack Welch, Intel Chairman Andy Grove, Enron Chairman Kenneth Lay, Goldman Sachs Chairman and CEO Henry Paulson, and AOL Time Warner Chairman Steve Case, all of whom have extensive international experience and are well known to the President.

They should explain that globalization is the

most powerful force acting on all government economies, and societies, and that an international strategy must be based on ramping economic engagement. This requires cooperative efforts not just to free up trade and investment but also to strengthen regulatory systems, banking, stock trading, antitrust, intellectual property rights, cyberspace, and corporate governance. This must occur both within countries and on a global scale. We need better arrangements for environmental protection and so safety nets to cushion change. Moscow and Beijing need to be integrated into global markets and the International Monetary Fund, the World Trade Organization, and the World Bank require strong support. There will be scarce progress on any of these issues if the U.S. continues to say what it doesn't want without offering alternatives, and if it proceeds with its high-handed unilateral approach.

EUROPE'S IMPORTANCE. CEOs also should criticize the Administration's obsession with Asia and Latin America. The top priority for American foreign policy should be closer ties with the European Union, the world's largest and second-most-powerful economic unit. Without the cooperation of the EU, there can be no global trade negotiations and no way to stabilize world markets in a financial crisis. In fact, there can be no meaningful progress on any big economic issue.

Because President Bush lacks international experience, business leaders need to educate him about the magnitude of the obstacles he faces to make globalization work. These include slowing economic growth and faltering stock markets, a growing number of bilateral trade deals that undercut prospects for more global agreements, widening income gaps between rich and poor. Add to that soaring resentment of America's declining image and substantial skepticism about the effects of global trade among many thoughtful U.S. citizens. Ending the cold war may have been simple by comparison.

It would be ironic if a Republican Administration staffed with many former business executives pursued a diplomatic strategy that backfires on our most important companies. Yet absent a U-turn in strategy, this could easily happen, the damage will overshadow any short-term corporate benefits of tax cuts and regulatory laxation. Business leaders can't completely reverse the Bush Administration's foreign policy but acting together personally behind the scenes they may have more power than they think. Now is the time to use it.

Jeffrey E. Garten is dean of the Yale School of Management. A former investment banker, Garten is the author of *The Mind of the C.E.O.* (jeffrey.garten@yale.edu).

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BY GENE KORETZ

A PHONY NEGATIVE SAVINGS RATE

Why consumers won't stop buying

A specter continues to haunt the U.S. economy. It is the fear that the low level of personal savings, which has turned negative for the first time since the Depression, heralds a massive retrenchment in consumption that will abruptly terminate the longest expansion in U.S. history.

Most experts link the huge slide in the savings rate from 5.6% in 1995 to

vate pension plans, which have been growing at a 7% to 8% annual rate for years. Rather than counting such pension benefits as income (as Social Security benefits are), the statisticians count corporate contributions to pension funds. And because such contributions weren't needed as fund assets grew during the equity boom, the official measure of personal income was held down, making it appear that people were spending out of their savings.

Similarly, the government doesn't count realized capital gains as personal income because such gains are not related to income generated by current production. Yet such distinctions have little if any impact on people's behavior. Individuals tend to view capital gains as part of their incomes and to spend or save them as they see fit.

Clearly, counting pension benefits and capital gains as income alters the picture of savings behavior. Barnes calculates that such adjustments would not only add 10 percentage points to last year's savings rate but would also show little decline in savings in recent years (chart).

What's more, realized capital gains on stocks this year will still be significant, since only people who have sold stocks bought in the past two years will have losses. And people continue to rack up capital gains from sales of other assets such as homes.

All of this suggests that the negative savings rate is a red herring. "Spending should slow in response to rising unemployment and the stock market woes of the past year," says Barnes, "but not disastrously."

THE LAST STEP UP IS A BIG ONE

Making CEO is not a lock for No. 2s

If you are an "heir apparent" to the chief executive officer of a major corporation, you might think that your path to the top would be relatively smooth—particularly if the company is doing well. But a study in the current *Academy of Management Journal* suggests that aspiring top dogs often face a major hurdle in the form of a powerful incumbent CEO—unless that power is offset by the power of outside directors.

In a random sample of large manufacturers, Albert A. Cannella Jr. of Texas A&M University and Wei Shen of Rutgers University traced the fortunes of 128 chief operating officers or presidents who were at least five years

younger than the incumbent CEOs of their companies. Over a 10-year period ending in 1996, they found that 65 made it to the corner office while almost half as many left. (The rest stayed put.)

What caused so many No. 2s to leave? The biggest factor was the power of the incumbent CEO, measured by such factors as corporate stock holdings and length of tenure. The more powerful the CEO, the researchers report, the smaller the No. 2 guy's chances of making it to the top and the longer the wait before promotion. A heirs apparent were especially likely to leave companies with powerful CEOs if corporate performance was high.

The path to the top was eased, however, if powerful outside directors—measured by their number and equity investments—were on the board. Director power, the study found, lessened the likelihood of No. 2s leaving high-performing companies and raised their chances of becoming No. 1.

LONDON DIGS ARE THE DEAREST

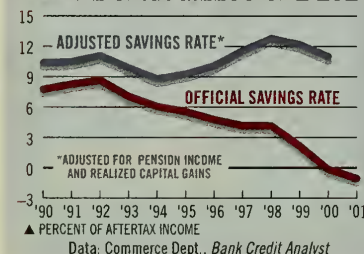
A global survey of luxury housing

In what major city would a two-bedroom apartment in a snazzy neighborhood cost the most in dollars? The answer, finds a survey by Corcoran & Global Real Estate, is London, where such an abode in Eaton Square averages about \$2.12 million. Two-bedroom flats in prime neighborhoods in San Francisco, Hong Kong, New York, Amsterdam, and Stockholm range from million down to \$1.55 million (chart).

Such apartments, however, can differ significantly in size. While the average two-bedroom ranges from 1,400 to 2,000 square feet in tony areas in London, San Francisco, Hong Kong, New York, for example, it jumps to a cavernous 4,800 square feet in Amsterdam's R. Wagnerstraat and a mere 860 in Paris' Saint-Germain-des-Prés. Thus, ranked by price per square foot, Amsterdam moves far down the list of expensive cities, while Paris jumps to 5th spot from 11th.



PERSONAL SAVINGS: MORE THAN MEETS THE EYE



-1% last quarter, to the stock market boom. As soaring stocks boosted wealth, consumers began to spend wildly on the assumption that share prices would move ever higher. Now that nearly \$4 trillion in stock market capitalization has evaporated, economic Cassandra say it is only a question of time before households slash spending to get their savings back on track.

Not so, says economist Martin Barnes of the *Bank Credit Analyst*, an investment publication, who argues that consumers have not been on a spending binge. "Most people have not stopped saving," he says, "and that implies that coming cutbacks in spending will be far less drastic than those who focus on the negative savings rate believe."

In calculating the savings rate, notes Barnes, the government defines savings as what is left over after consumer spending is subtracted from aftertax personal income. For reasons related to accounting conventions, however, some items that households regard as income are not included in the government's income tally, while some that households ignore are. The upshot is a false picture of savings behavior.

A case in point is benefits from pri-

JAMES C. COOPER & KATHLEEN MADIGAN

WILL A RAINY SECOND QUARTER TAKE FOR A SUNNY SECOND HALF?

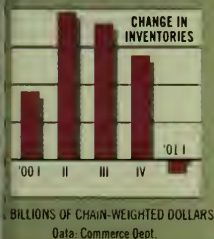
Frastic inventory reduction clears the way for future output gains

U.S. ECONOMY

Recession? What recession?

The surprising news that the S. economy grew at a not-too-shabby 2% annual rate in the first quarter, a pickup from 1% in the fourth quarter, went a long way to allay fears that the 10-year expansion was going down the tubes. So are we out of the woods? Not yet. Second-quarter growth in real gross domestic product is likely to be weaker, because some of the factors that boosted first-quarter GDP, such as a sharp narrowing in the trade deficit and a lift from government outlays, are not offering the same support this quarter. Consumer spending and housing also are likely to add less growth, even as capital spending by businesses, especially for high-tech equipment, continues to decline. Add it up and the best prospect is for little, if any, growth.

INVENTORIES ARE DRAWN DOWN SHARPLY



Looking toward the second half, though, the GDP data show that a huge roadblock has been largely cleared. Because demand held up fairly well, inventories were drawn down drastically (chart), especially in the auto sector, eliminating a big chunk of the excess stockpiles that had been choking many businesses and leading to production cuts and massive layoffs. The recession in manufacturing may be bottoming out, as suggested by the recent uptick in the purchasing managers' index.

With the inventory adjustment well under way, the outlook right now boils down to a tug-of-war between the plus from consumer spending and the minus from business investment in new equipment. It's a struggle that will keep the Federal Reserve in a rate-cutting mind-set this spring and summer, despite the first quarter's stronger-than-expected growth. The Fed will be especially sensitive to weakness in the labor markets and its potential to drag down consumer spending.

THE FED WILL ALSO keep a sharp eye on capital spending. In various speeches, Fed Chairman Alan Greenspan has voiced concern over the problems in the tech sector. But the overall first-quarter growth surprise highlights a key point about technology and its role in the economy: In the long run, the tech sector is reshaping the economy's structure and enhancing its

growth potential by lifting productivity. But in the short run, while tech clearly exerts more influence on the business cycle, other sectors, such as consumer spending, are still far more important.

Even so, business spending is worth watching because the capital spending boom fueled the productivity gains that blessed the U.S. economy with low inflation. That boom is now fading. Total business investment in equipment fell at a 3.3% annual rate in the fourth quarter and at a 2.1% rate in the first, as businesses adjusted to life in the slow lane. Real business investment for tech equipment dropped at a 6.4% rate last quarter, the first decline in 10 years.

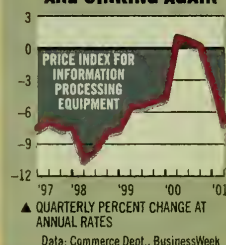
As bad as that number looks, the decline was much smaller than had been suggested by the monthly data on tech orders and shipments. The reason: Those data are not adjusted for prices, and tech prices began to fall once again in the first quarter at an increasingly rapid rate (chart). In particular, prices for computers and peripheral items plunged at a 28.5% annual rate, the largest quarterly drop in almost three years.

As a result, the dollar value of tech outlays fell at a 12.8% annual rate, but the real volume declined by only half that much. Price-cutting is hammering tech companies' profits, but in terms of GDP growth, it is limiting the downdraft from tech weakness and speeding up this sector's efforts to cut excess inventories. Indeed, tech inventories dropped sharply in March.

IF PRICE-CUTTING to clear out inventories sounds familiar, it should. It's the strategy used by carmakers who plied buyers with generous incentives. After averaging an annual rate of 17.2 million in the first quarter, carbuying in April slipped to a still-strong 16.6-million rate. Thanks in large part to the auto adjustment, business inventories in the first quarter fell for the first time in almost a decade.

In fact, the swing from inventory accumulation of \$55.7 billion in the fourth quarter to a \$7.1 billion liquidation in the first was the largest in the postwar era. It subtracted 2.5 percentage points from overall growth, and yet the economy still managed to grow at a 2% rate. Of that nearly \$63 billion swing in price-ad-

TECH PRICES ARE SINKING AGAIN



justed stockpiles, retail autos contributed \$29 billion.

Now, Detroit is building cars again. Based on the industry's second-quarter production schedules, auto output is set to contribute at least a percentage point to the quarter's GDP growth. That follows drastic production cuts that subtracted 0.9 points and 0.7 points from growth in the fourth and first quarters, respectively.

BUT OTHER INDUSTRIES were slashing stock levels as well, and the success of those efforts helps explain why the purchasing managers' index of industrial activity has bounced off its low point. The index edged up to 43.2% in April, from 43.1% in March and from January's low of 41.2%. That's still below 50%, meaning that factory activity continues to lose ground, but the rise in the purchasers' index of new orders looks encouraging for future output gains (chart).

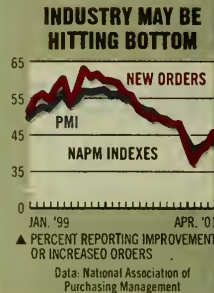
Clearly, some businesses are lifting orders to meet resilient consumer demand. Household outlays rose at a 3.1% rate last quarter, and consumer spending's contribution to GDP growth has more than accounted for overall economic growth in each of the past three quarters. The single most important factor for the consumer outlook is just how stalwart shoppers will remain in coming months as the labor markets soften.

The extent to which job markets sag will depend on an often-ignored dark feature of the New Economy: Businesses can boost their output more easily by in-

creasing productivity than by hiring new workers. With full employment now generally believed to be consistent with GDP growth in the 3.5% to 4% range, growth slowdown to the 1% to 2% range will open considerable slack in the labor markets. Already, job claims in early April tipped over the key 400,000 mark, a level that suggests little, if any, job growth.

Moreover, with wages and benefits up 4.1% from a year ago, as measured by the employment cost index, workers are becoming more expensive for businesses to hold on to, even as pricing power remains limited and profits get squeezed. But on the plus side, pay is rising faster than inflation, providing solid support for household spending.

When the books are closed on 2001, the second quarter may well prove to be the weakest quarter of the year. Both consumer and business outlays are under intense pressure from softer job markets and profit squeeze, respectively. However, the first-quarter growth surprise, in addition to the Fed's aggressive rate-cutting and the Bush Administration's prospective tax breaks, offer the best hope yet that a recession will be averted and that growth is set to pick up in the second half.



EURO ZONE

INFLATION PARALYZES THE ECB

The European Central Bank is in a bind: The latest data suggest that the impact of the global slowdown on the euro zone is intensifying, even as inflation continues to pick up. The ECB, limited by its commitment to price stability, can only wait for an opportunity to cut rates. And that may not come until summer.

Business confidence across the single-currency area is weakening, most recently in Belgium and the Netherlands, and most significantly in Germany, where it hit a 20-month low in March. France is a bright spot. Domestic demand there is buoyed by tax cuts and improving job markets, similar to the growth story in

Italy. But weaker exports are slowing growth in both countries.

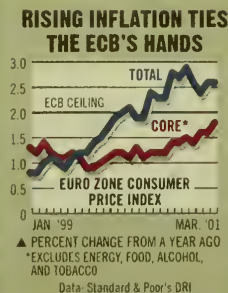
Most important, the German government recently sliced its 2001 growth projection, from 2½% to 2%.

The final rate may be even lower. Retail sales this year have been disappointing, suggesting that the lift from recent tax cuts has been less than hoped for. In addition, wages are failing to keep up with inflation, another drag on German consumer spending. And capital spending is slowing as global business investment, especially in the U.S., sags.

The ECB's dilemma is that rising inflation prevents the bank from cutting interest rates to spur

growth. Moreover, the higher inflation is contributing to sluggishness in domestic demand, since higher prices rob households of purchasing power. Inflation readings from Germany, Italy, and Belgium hint that euro zone inflation in April could jump to near 3%, from 2.6% in March, a percentage point above the ECB's 0% to 2% target range. Euro zone inflation has been above the ECB's range for 11 months (chart).

The main inflation pressure stems from temporary runups in energy and food, the latter the result of the foot-and-mouth scare. However, core inflation is also rising close to the 2% ceiling. Both overall and core inflation are expected to peak this summer, at which time the ECB will feel comfortable in joining the rate-cutting policies of the rest of the world.



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mobile business

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OUTAGES LIKE
THIS ONE ON
MAR. 19, IN
SAN FRANCISCO,
COULD
REOCCUR IN
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DARK DAYS

Costly gasoline,
tight supplies,
rolling
blackouts—
this crisis
could imperil
the economy

Vice-President Dick Cheney tapped into the nation's black mood on Apr. 30 when he declared that the U.S. faces a "present crisis" in energy. Heads nodded all around: There's a nasty feeling that the bad old 1970s are back. Gasoline prices have zoomed to record highs as overstretched refiners struggle to cope (page 45). In hard-hit Chicago, gasoline prices rose 25¢ in April alone—and full-service premium goes for \$2.46 a gallon downtown. Natural-gas inventories remain tight, raising concerns about another price spike like the one that skewered consumers last winter. The U.S. electricity market is in an uproar, a combination of

California's bungled deregulation and nationwide growth in consumption that has outpaced additions to generating capacity. California is bracing for more rolling blackouts this summer, and there's a chance the lights could go out in metro New York as well if it gets hot enough. Even coal, usually plentiful and the main fuel for electricity, is causing trouble, with prices up in some cases nearly 130% since 1998.

Add it all up, and the bill for energy of all kinds keeps rising. Power expenditures zoomed 39% from 1998 through 2000, and are likely to rise another 9% this year in spite of the economy's sluggish growth, estimates Standard & Poor's DRI. That represents a huge drag on the economy. In fact, the increase in energy prices since 1998—close to \$200 billion—swamps the \$100 billion that might be injected into the economy this year by the Bush Administration's proposed tax cuts.

AD?

What's more, the drain is socking the S. at a time when it is more vulnerable to the stagflationary impact of high energy prices than it was a year ago. Economic growth slowed to 2% annual in the first quarter, down from 5% last year, and the inflation measure in the gross domestic product report accelerated to a 3.2% annual rate. The biggest factor behind the surge in inflation was a 34% annual increase in electricity and natural-gas prices in the first quarter. David A. Wyss, chief economist of Standard & Poor's, says the economy will probably show a half-percent less this year than would have if energy prices had stayed at their 1998 low. Corporate profits, too, have been hit hard. In the first quarter, according to a preliminary tally of more than 800 companies in the *BusinessWeek* Corporate



ELECTRICITY

With demand rising faster than supply, producers are stretched thin. California could see rolling blackouts again this summer. Metro New York could get hit, too. Lots of new power plants are in the works, but there aren't enough transmission lines.



GASOLINE

The combination of high crude prices, strong demand, and too few refineries has sent prices soaring. The national average retail price for regular-octane gasoline hit a record \$1.63 in April. Refiners, fearful that big profits won't last, have been slow to add capacity.



NATURAL GAS

Last winter, spot wholesale prices quadrupled. Though now down from that peak, prices are still double last year's. With more gas-fired power plants coming on line and inventories low, prices could spike again next winter.



COAL

Dirty but dependable, coal usage has risen as natural gas has gotten more expensive. Coal produces 54% of U.S. electricity. Prices are up as much as 130% from last year. Some utilities are lobbying for easier air-pollution rules so they can burn more coal.

THE ENERGY CRUNCH

Scoreboard, rising energy prices contributed to a 26% decline in overall earnings, the biggest drop in nearly 10 years. The only ones profiting from the crisis are the energy companies and their investment bankers (page 47).

Amid the gloom, however, there is one bright spot: Once the U.S. gets through this year, the outlook could brighten considerably as market forces help add supply. Just as in the past, sustained high energy prices are garnering a strong response, encouraging producers to bring new supply online and prompting conservation efforts by energy users.

Last winter's high natural-gas prices have set off a rush of gas exploration, for example, with more domestic drilling rigs now in operation than since 1986. Oil prospecting is up as well. Lehman Brothers Inc. says U.S. oil and gas companies plan to increase worldwide ex-

ploration and production budgets 19% this year. As for electricity, the North American Electric Reliability Council predicts a surge in energy-generating capacity. Last year, it projected 100,000 to nearly 200,000 megawatts of capacity would be added by 2004, vs. just 60,000 megawatts of added demand.

FUTURE SHOCKS. Financial markets, moreover, are signaling that prices should fall over the next year as new supplies emerge. Hedgers can purchase natural gas at \$5 per million BTUs for December delivery, vs. more than \$10 last December. Wholesale gasoline can be had at 79¢ for November, vs. \$1.03 now. Wholesale contracts for summer electricity in the Midwest have also plummeted 20% in the past two months, while West Coast summer contracts are down 30% since Apr. 10, according to surveys by Platts Energy Trader.

The Administration's energy plan,

High prices could break the confidence of consumers, who account for two-thirds of the economy

based on the preview from Cheney, would encourage this long-term private-sector response by focusing on supply (page 46). Key elements of the plan include removing regulatory obstacles to the construction of new refineries and power plants—including nuclear plants—and spurring oil and gas exploration in the Arctic National Wildlife Refuge. The Democrats have countered mainly by advocating more stringent energy conservation laws.

But in both cases, the proposed measures offer primarily long-term solutions. Neither party has much to say about short-term fixes—largely because few government actions would help much in the short term. Emergency interventions, such as siphoning oil from the Strategic Petroleum Reserve or slapping controls on wholesale electricity prices, tend to be ineffective or counterproductive.

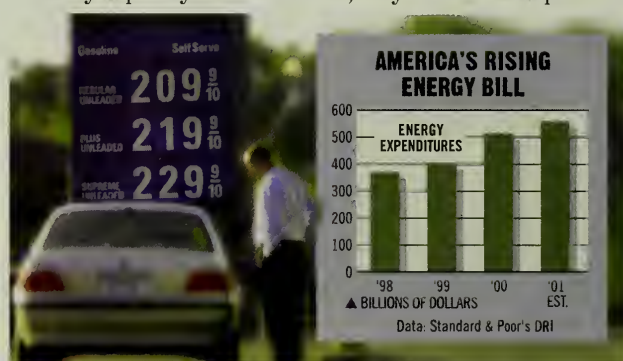
This doesn't mean the short-term dangers to the economy aren't real. Over the past three decades, energy price spikes have been a key contributor to economic downturns. One concern now is that the Federal Reserve will hold off on needed rate cuts because of fears of energy-induced inflation. Indeed, the Fed warned in its Beige Book report on May 2 that "upward wage pressures have generally abated, only to be replaced with energy costs that have risen sharply." At the same time, soaring energy prices and potential blackouts in some areas could add to consumer anxiety, already fragile due to rising unemployment and the tumultuous stock market. That would be dangerous, because consumer spending accounts for two-thirds of the economy.

Although an energy-crisis-induced recession is still unlikely, it isn't out of the question. Standard & Poor's Wyss believes the deciding factor is California, which accounts for 14% of U.S. output. If there's an energy-induced recession in California, says Wyss, "the rest of the country would be hard-pressed to keep growing." State officials warn that there could be 34 days of rolling blackouts this summer if usage isn't curtailed. The state's biggest utility is in Chapter 11, and some independent power producers have shut down because they haven't been paid by utilities. Sung Won Sohn,

chief economist for Wells Fargo & Co., has cut his projections for the state's real growth from 3% to 1% for 2001.

Many California manufacturers say that if something isn't done soon, they'll leave or close. Universal Plastic Mold of Baldwin Park, Calif., has a contract with Southern California Edison that gives it a discount in return for agreeing to allow its power to be cut off in an emergency. For 9½ years, it was never shut down. This January, power was cut 16 times. Now, prices are going up 46%. "We're not immune to being put completely out of business," says Co-owner

located in the Pacific Northwest to take advantage of cheap hydropower are being asked by the Bonneville Power Administration to shut down for up to two years to free up electricity for other customers. Residents worry that if they do, the jobs may never come back. "It is sad when small rural economies are destroyed—people in larger metropolitan areas can continue their lifestyle unaffected." Robert Abernathy of Blaine (Wash.) wrote in a recent letter to *BusinessWeek*. Rural America is also being hurt by a 73% surge in nitrogen-based fertilizer prices since January, according to DRI.



Don Ashleigh. And FeRx Inc., a San Diego biotech company is building a factory out of state, near Denver, to save money. Says CEO Jacqueline Johnson: "I can't imagine, with the current energy situation, ever putting a facility like this in California. It would simply be too expensive."

It's not just California residents and businesses who are feeling the ill effects of costly energy. UAL Corp. President Rono J. Dutta blames the airline's \$305 million first-quarter loss in part on a 27% increase in fuel prices from a year earlier. UAL stopped hedging fuel prices at the end of 2000, thinking that they were bound to fall as the economy slowed. But the reverse occurred. "It's unusual for fuel costs to go up like this into a recession," says Dutta.

For Dow Chemical Co., the killer is raw material costs. Dow paid \$600 million more in the first quarter for energy and hydrocarbons—oil derivatives used to make chemicals—than in 2000's first quarter. It managed only \$80 million worth of offsetting price hikes. The company called it "one of the most challenging quarters for the North American chemical industry, and also for Dow."

Meanwhile, aluminum smelters that

"COVER MY EYES." Consumers everywhere are facing a second summer of costly gas. The average national price for regular gas, \$1.10 as of Apr. 30, is the highest ever, before adjusting for inflation. Price increases are steepest in the Midwest, where refiners are once again having trouble meeting regional pollution rules. Big drivers in every state are feeling the pinch. "I just cover my eyes when I swipe my card" at the pump, says Jim Rowe, who works for an information-services company in Atlanta.

Inevitably, paying energy bills requires trimming back elsewhere. Brian Kiefer, 36, a father of four in Newton, Pa., says that when his family drives the shore on weekends now, they pass a lunch and return in time to have dinner at home, to make up for increased gas expenses. And Amanda Huffman, a student at Agnes Scott College, a private all-girls school in Decatur, Ga., has also cut back: "We used to go out and just drive around and go to random places because it was fun," she says. "But now we carpool or don't go out." Multiply their stories by the millions, and it's easy to see how the current energy crisis looms large over the lives of most Americans—and how it may yet bring down the U.S. economy.

By Peter Coy in New York, Stephanie Anderson Forest in Dallas, Michael Arndt in Chicago, Ushma Iyer in Atlanta, and bureau reports

BusinessWeek online

For regular coverage of energy issues go to www.businessweek.com/today.htm



OUT OF COMMISSION
Half of all working
refineries have been
shut down since 1981

COMMENTARY

By Christopher Palmeri

WHY WE NEED TO SIMPLIFY FUEL STANDARDS

THE ENERGY CRUNCH

It looks like the preview for a scary summer movie. With the high season for driving just around the corner, the price of regular unleaded averages \$1.62 a gallon, pennies shy of the \$1.67 high from last June. In many markets, it tops \$2. Although surprisingly strong inventories trimmed wholesale gas prices by a dime, to \$1.03, in recent days, consumers are worried. "I drove around forever with my fuel light on, just hoping prices would go down," says Pamela Haber, a 31-year old mental health counselor in Los Angeles. "They just kept going up."

With inventories up, some analysts say prices may be peaking. But that's unlikely to mean the quick return of cheap gas. Inadequate refinery capacity is a major reason behind recurring price hikes—and that problem has been years in the making.

NOTHING TO SPARE. Since 1981, poor returns on investment and increasingly stringent environmental controls have forced more than half of the working refineries in the U.S. to close. Meanwhile, no new ones have been built since 1976. To keep up with demand, the average U.S. refinery is running flat-out: Capacity utilization now stands at 98.8%, up from 84% in 1991. "There is no spare capacity," says William E. Greehey, chairman of Valero Energy Corp., a refiner based in San Antonio.

Vice-President Dick Cheney has made clear that as part of its energy plan, the Administration will propose

trimming environmental and other regulations that prevent refinery construction. But that's a long-term solution at best. Even with no local or environmental opposition, refineries take years to build.

Can anything be done in the short term? Cheney is also expected to propose harmonizing the nation's bewildering patchwork of fuel formulations, which many blame for causing bottlenecks in the market and making refining more complex and costly.

The reason: In 1990, the Clean Air Act Amendments included federal requirements for cleaner-burning gas in nine especially smoggy cities. Some states and cities went further and created tougher standards. Add it all up, and the refining industry must manufacture fuel with 16 different formulations in three grades each.

Simplifying the variety will help.

With so many unique formulas and few sources of extra supply, prices spike in times of shortages. Indeed, a 1999 investigation by the California Attorney General's office found that prices in the state had been more volatile since it instituted its own blend of cleaner-burning gas in 1996.

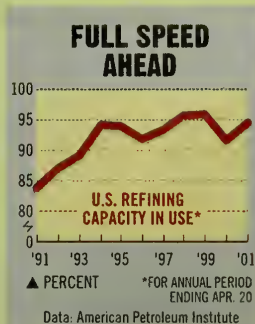
Some local officials are already trying to harmonize regulations. In the mid-1990s, for example, Missouri regulators tried to adopt the federal standard for Kansas City. But fearing the imposition of

stricter standards in other cities, the oil industry sued and prevented it. "We've tried to promote common formulas whenever we can," says Robert Randolph, an environmental engineer with Missouri's Natural Resources Dept.

UNLIKELY ALLIES. The issue has made allies of some unlikely parties. Last year, the American Petroleum Institute, American Lung Assn., and health-related groups lobbied Congress to do away with the federal requirement to include cleaner-burning oxygen additives in gas. They recommended that oil companies be allowed to choose their method for achieving environmental standards. But that deal lacked support from legislators who favor ethanol, a corn-based oxygen additive used to produce cleaner fuels in the Midwest.

Clearly, getting a national consensus on a more limited number of

national standards won't be easy. But considering the lack of alternatives and increasingly angry consumers at the pumps, it's a step in the right direction. Even some environmentalists are in favor. "We'd be interested in a national standard, if it's a clean one," says Daniel Becker, director of the Sierra Club's energy research. It may be one of few energy questions on which he and Cheney agree. With Laura Cohn and Lorraine Woellert in Washington, D.C.



COMMENTARY

By Paul Raeburn

DON'T WRITE OFF ENERGY CONSERVATION, MR. CHENEY

Give Vice-President Dick Cheney credit; he says what he thinks. In his Apr. 30 speech in Toronto previewing the Bush Administration's energy policy, he bluntly rejected conservation as a major part of the solution to the current energy crisis. His plans focus almost exclusively on boosting domestic oil sources, building refineries, and laying natural-gas pipelines. Conservation, Cheney said, "is not a sufficient basis, all by itself, for a sound, comprehensive energy policy." Moreover, he added, the government shouldn't "step in to force Americans to consume less energy."

Cheney is right in one respect: There's no question that the U.S. must increase supplies of electricity and gasoline. But his needlessly harsh rejection of conservation sets up a false dichotomy. We need not choose between boosting supply or cutting demand: The President's energy plan should do both.

SMALL SACRIFICE. Cheney misconstrues the argument for conservation. Americans don't have to stop driving their SUVs or unplug their air conditioners. The point is to encourage development of more efficient cars, appliances, and power plants, which would cut energy demand without causing consumers too much pain.

The Administration is moving in the opposite direction. Not only does it dismiss conservation as part of its energy plan, it has proposed budget cuts of 30% or more from existing federal energy-efficiency research and development programs. That includes Energy Dept. projects to develop more efficient appliances, heating and cooling systems, and buildings. It also wants to cut projects to develop energy-efficiency R&D partnerships with industry.

Yet there's plenty of real world experience showing that efficiency pro-

THE ENERGY CRUNCH

grams not only save energy, they often cut costs as well.

Ford Motor Co., for example, trimmed its electricity bill by \$2.5 million per year when it installed efficient lighting in seven manufacturing plants. And replacing old boiler houses in plants reduced natural gas use by 50% annually.

According to the Washington-based Alliance to Save Energy, a nonpartisan group formed to promote efficient

eliminated the need for at least a dozen new 400-megawatt power plants while only minimally raising air-conditioner prices.

Improving the fuel efficiency of automobiles would also go a long way to cutting U.S. energy demand. The American Council for an Energy-Efficient Economy, in Washington, concludes in a new report that boosting fuel efficiency by 5% a year over the next 10 years would reduce oil demand by 1.5 million barrels per day by 2010 and 4.8 million barrels per day by 2020. Currently, the U.S. imports about 10 million barrels per day.

Already, Ford has promised to boost the efficiency of its SUVs by 25% in the next five years, and General Motors and DaimlerChrysler have pledged to do what Ford does. The Administration ought to develop policies that build on the auto makers' own efforts to raise standards. Or it could develop incentives to help spur sales of new, highly efficient hybrid vehicles and fuel-cell-powered cars—expected to debut in the next few years—which could



Energy-efficiency R&D has saved Americans \$100 billion since 1978

SHOPPING FOR BETTER WATER VALVES IN CALIFORNIA

energy use, the \$12 billion the Energy Dept. has invested in energy-efficiency R&D since 1978 has saved consumers \$100 billion in energy costs. The alliance cites a General Accounting Office report that found \$50 billion was saved thanks to DOE programs encouraging efficiency in such things as fluorescent lighting, refrigerators, and building designs.

Or take the Administration's April decision to relax air-conditioner efficiency standards issued in the final days of the Clinton Presidency. Clinton wanted a 30% increase in efficiency; Bush lowered that to 20%. The tighter standards would have

substantially cut energy demand. "We're asking Congress for tax incentives for consumers, to help get the vehicles on the road," says Gloria Bergquist, vice-president of the Alliance of Automobile Manufacturers.

It's unclear why Cheney took such a hard line against conservation. Perhaps it's because he has an oilman's view of the world: Drill, drill, drill. Maybe he was simply staking out a tough bargaining position. Let's hope so. Conservation needs to be part of the solution to the nation's energy crisis. Cheney ought to give it another look.

With bureau report

HERE'S A NEW BLOCKBUSTER N WALL STREET

energy IPOs, and the banks underwriting them, are red-hot

Lugh McGee, co-head of Lehman Brothers Holdings Inc.'s global energy practice, is busier than ever. McGee and his team of 45 bankers are working weekends and nights. They're canceling vacations. And they're hitting the road to deliver a simple message to energy company CEOs: Dot-coms are out. Energy is in. "We're telling them that it is a favorable environment for getting transactions done, and the financial markets are wide open," McGee says.

Welcome to the latest new thing on Wall Street. So much for the tech boom; like McGee, legions of energy bankers are lining up for deals these days. And many are striking it rich. On May 1, Reliant Resources, a Houston power generating and trading company, raised \$1.56 billion. It was this year's third-largest IPO, after Agere Systems and McGraw Consulting Inc., respectively. Up 10% in two weeks, Reliant could also add to the ranks of this year's best-performing IPOs. Reliant's shares of Williams Energy Partners have risen 55% since its February offering.

RUSH IS ON. All told, Wall Street has raised a stunning \$3.6 billion for energy companies, including Reliant, Allegheny Energy Inc., Calpine, and Aquila

Cashing In

With fees for tech equity offerings plummeting, Wall Street believes it has found a new gusher

	JAN-APR., 2000	JAN-APR., 2001
	FEES (IN MILLIONS)	
TECHNOLOGY	\$2800	\$351
ELECOM	706	43
OIL/GAS/UTILITIES	62	266

Data: Thomson Financial Securities Data Corp.

Inc. in a spate of initial, secondary, and convertible equity offerings over the seven days ended April 30. "This is the strongest equity market for new issuance that I've ever seen" for energy companies, says Doug Kimmelman, chairman of Goldman, Sachs & Co. global energy investment banking group.

The reason: With America on the brink of its worst energy crisis in a decade, the long-shunned oil and gas business is gushing profits, making it suddenly sexy to investors and bankers. Players ranging from oil company Anadarko Petroleum Corp. to independent power producer Calpine Corp. are racking up record earnings. "Energy has replaced technology as investors' favorite sector," says Richard Peterson, chief market

strategist at Thomson Financial Securities Data Corp.

Indeed, energy is now one of the few sectors still greasing Wall Street's wheels. In the first four months of this year, Wall Street earned almost as much in fees from issuing equity for oil, gas, and utilities as it did from technology companies over the same period. Investment bankers pulled in \$266 million in disclosed fees from issuing equity for oil, gas, and utilities vs. \$351 million from technology issues.

"UNPRECEDENTED." And this is just a fraction of what Wall Street will earn financing the massive expansion plans to solve America's energy crisis. Credit Suisse First Boston expects energy-related companies to account for as much as 20%—or \$30 billion—of an estimated \$150 billion in equity that Corporate America will issue this year. They will also raise billions from loans and bonds. "We believe the financing requirements over the next few years will be unprecedented," says Jonathan Bram, a managing director in CSFB's global energy group. It has arranged more than \$11 billion worth of syndicated bank loans for energy companies so far this year.

Energy companies are also filling up banks' merger-and-acquisition pipelines. No one expects a flurry of megadeals like the ones in 1998 and 1999, when Exxon purchased Mobil and British Petroleum snapped up both Amoco and Arco. Consolidation among the big players has gone so far that further deals would raise antitrust concerns.

But there are plenty of smaller deals to be done. Houston energy consulting firm John S. Herold Inc. estimates that oil and gas exploration companies are now peddling oil and gas reserves worth more than \$40 billion. Some European players are also shopping for power companies to expand their reach in North America. Bankers believe London-listed utility group Scottish Power is considering a \$3 billion bid for U.S. energy group Portland General Electric. "It's no secret we are looking to expand in the U.S.," says a Scottish Power spokesman.

Of course, the black gold rush may dry up if the nation's power supply catches up with demand; if crude oil or natural gas prices dip, investor enthusiasm could as well. Then Wall Street will undoubtedly move on to the next big thing.

By Emily Thornton in New York



THE
ENERGY
CRUNCH



AUTOS

THE ROAD LOOKS ROUGHER FOR MOTOWN—AND THE ECONOMY

As consumer confidence dips, robust sales may melt away

Don't tell car dealer Jon J. Agresta that the fate of the economy rests partly on his shoulders. After rebates sparked three months of unexpectedly strong sales for the six General Motors Corp. brands he markets at his two central New Jersey dealerships, business plummeted 30% in April. "Our sales were dismal," gripes Agresta.

He isn't alone. Although U.S. auto sales held up far better than expected in the first quarter, the market is finally starting to crack. Vehicle sales for the month of April fell 10% from a year earlier. On a seasonally adjusted basis, that means that the U.S. auto market is now chugging along on pace to sell just 16.6 million vehicles this year—a 4% drop from the 17.3 million pace set in the first quarter. Worse, the Big Three have been hardest hit. While their sales fell 16% from one year ago, foreign rivals' sales grew 3%, and profits have tumbled at all three. In sum, it makes for some pretty bleak prospects for Detroit these days.

QUICK REFLEXES. Still, give credit where credit is due: Today's weakening performance stems in part from the great job Detroit did reacting to the economy's downturn in recent months. As inventories piled up on lots late last year, carmakers reacted far more swiftly than

in the past to slash production and offer up discounts to move the metal. That fueled stronger-than-expected sales in the first quarter. The result: The industry took just three months to work off an inventory bulge that had threatened to dampen the economy for much longer.

That's good news for the economy overall. The first quarter production cutbacks took a big toll. Overall, the slowdown in the auto sector shaved 0.7% off of growth in gross domestic product in the first quarter. But with inventories depleted, Motown is ramping up again with modest production increases. As troubles continue in every sector from tech to retail, the timing couldn't be better: Economists now predict that the auto sector will help boost second-quarter GDP anywhere between 0.5% to 1.25%. Crows Bank One Corp. economist Diane C. Swonk: "This ain't a downturn."

So why isn't anyone around Detroit breaking out the champagne? With a number of factors working to curb domestic car sales, the second-quarter gains could be short-

POTHoles GALORE

Along with the limp economy, Detroit faces higher gas prices and Japanese rivals smelling blood

lived. Gas prices are high, unemployment is up, and though record level incentives helped for a while, they're no longer spurring sales.

The reason: The slowing economy finally seem to be taking its toll on consumer confidence, a key factor in auto sales. In April, consumer attitudes fell 3.4% from March and 19% from year-ago levels, according to the University of Michigan's recent index of consumer sentiment. Worse, the largest decline in attitudes was for autos. "If people are really worried about the future, it does matter if they can get a good deal on a \$20,000 car," says Merrill Lynch & Co. analyst John A. Casesa.

JAPANESE GAINS. Moreover, those who are buying are opting more often for foreign rivals; Japanese and Korean automakers grabbed 4 percentage points of share in April to take almost 31% of the U.S. market. With new models in the lucrative sport-utility and mini segments, both Honda Motor Co. and Toyota Motor Corp. are gaining ground in the segments where the Big Three make most of their profits. And though they have historically relied less on incentives, Asian makers have lately gotten more aggressive. Toyota and Honda have each added at least \$600 in incentives on bread-and-butter Camry and Accord sedans, respectively. With the yen flirting with a 12-month low, there's reason to believe they won't stoke rebates further. Says Chrysler Group's Dieter Zetsche: "The Japanese always have gone for market share."

That's one more reason why many economists expect Detroit's boost to be short-lived. Standard & Poor's chief economist David A. West says that the auto industry will shave one-quarter of third-quarter GDP and, at best, will be a wash in the fourth quarter. The auto industry "will be a drag on the economy for a while," he says. So enjoy your second-quarter blip while it lasts.

By David West
Detroit, with Joe Muller and
Miller in Washington, D.C.

THAT'S SOME DING

YEAR-OVER-YEAR PERCENT CHANGE IN U.S. AUTO SALES

2000 2001

O N D J F M A

SEASONALLY ADJUSTED ANNUAL SALES RATE

16.6 MILLION

Data: Autodata Inc.

MERRILL LYNCH MICROSOFT HEWLETT-PACKARD IBM IXL NETWORK ASSOCIATES ROCKWELL SOFTWARE IBM
HANCOCK FINANCIAL SERVICES VERIZON CHOICE HOTELS SUN MICROSYSTEMS ERICSSON MICROSOFT NETWORK A
BAY DELOITTE CONSULTING SUN MICROSYSTEMS HEWLETT-PACKARD IBM EBAY DELOITTE CONSULTING VERIZON
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RTIN EBAY HEWLETT-PACKARD SUN MICROSYSTEMS VERIZON IBM NETWORK ASSOCIATES ALCATEL MICROSOFT

WHO HELPS ERICSSON PUT THE INTERNET IN YOUR POCKET? RATIONAL SOFTWARE.

HOTELS LOCKHEED MARTIN CONTEXT INTEGRATION SUN MICROSYSTEMS EBAY MICROSOFT ALCATEL NETWORK A
OFT HEWLETT-PACKARD MERRILL LYNCH JOHN HANCOCK FINANCIAL SERVICES COMMERCE ONE WELLS FARGO IBM
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S FARGO IXL NETWORK ASSOCIATES AUSTRALIAN STOCK EXCHANGE SUN MICROSYSTEMS MICROSOFT IXL MERRILL
MS ERICSSON VERIZON MICROSOFT IBM ALCATEL ROCKWELL SOFTWARE EBAY CONTEXT INTEGRATION JOHN P

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COMMENTARY

By Dan Carney

PREDATORY PRICING: CLEARED FOR TAKEOFF

When a federal judge threw out the Justice Dept.'s "predatory pricing" case against American Airlines Inc. on Apr. 27, it wasn't even front-page news in most cities. But the ruling, which the Administration is not expected to appeal, will likely have an impact well beyond the airlines. "This case represented the department's best efforts to fashion a predatory-pricing doctrine for the New Economy," observes Washington antitrust attorney Robert

So Justice attorneys argued that the test should be updated. Specifically, they suggested that U.S. District Judge J. Thomas Marten, based in Wichita, should determine whether there was any business justification for American's aggressive pricing, other than driving away competition.

Under that definition, trustbusters thought they had a great case. Every time a fledgling airline tried to get a toehold in the Dallas market, for example, American met its fares and added flights. As soon as the rival retreated, American jacked fares back up. Be-

to the old definition of predatory pricing. "American priced its fares consistently above its average variable costs," Marten wrote. While Marten acknowledged that predatory pricing existed, he doubted that judges would be able to distinguish it from good, old-fashioned competition. "Identifying [predatory pricing] in the particular case without chilling aggressive, competitive pricing is far beyond the capacity of any antitrust tribunal," he wrote, quoting from a well-known antitrust treatise.

"SOLE SURVIVOR." Now that the average-variable-cost standard has been etched into law, it will be a lot easier for dominant companies to drive their rivals out of business.

"This effectively means there can be no price predation" in industries with low variable costs, says New York University law professor Eleanor M. Fox. Beyond airlines, these industries are primarily found in New

Economy sectors. Most of the

cost of making software, chips and prescription pills, for example, is in research and development. Once that money has been spent, the cost of making additional units is tiny. In

these businesses, aggressive pricing can leave dominant companies "as the sole survivor," says analyst Roger Kay, of IDC in Framingham, Mass.

Indeed, Intel and Dell Computer have recently begun aggressively cutting prices. Nobody is accusing them of illegal predation. But in the wake of Marten's decision, they may be able to lower prices into previously unexplored territories.

Of course, low prices sound great for consumers. And they frequently are. But so is competition. Marten's ruling, by putting whole parts of the economy off-limits to predatory-pricing suits, could wind up costing some consumers a lot more than peanuts.

Carney covers legal affairs from Washington.

A federal judge's ruling makes it easier for big companies to shut rivals out

A. Skitol.

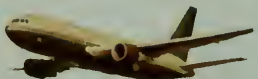
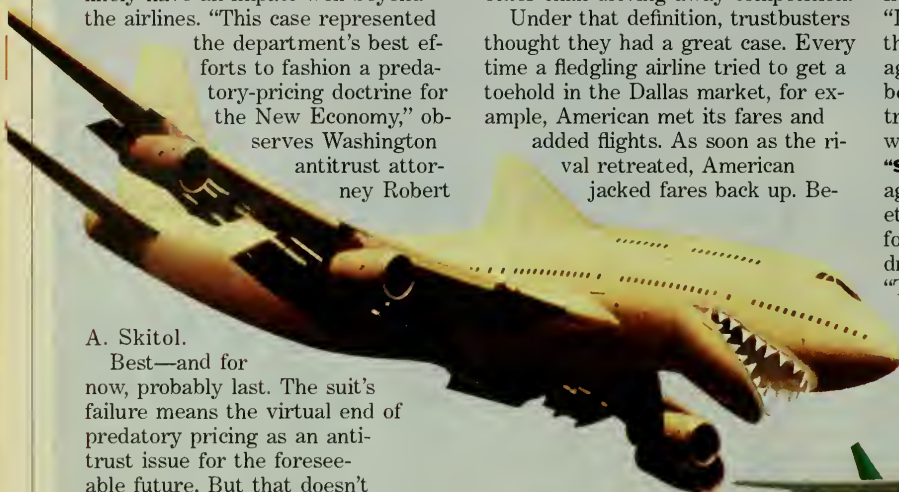
Best—and for now, probably last. The suit's failure means the virtual end of predatory pricing as an anti-trust issue for the foreseeable future. But that doesn't mean the problem will go away. Instead, the judge's ruling opens the door for dominant companies to wage bare-knuckles price wars against pesky smaller competitors. The consequences could be especially serious in New Economy industries such as software, chips, and computer hardware.

UNIMPRESSED. Here's why. To win a predatory-pricing case, trustbusters traditionally had to prove that a company sold products or services for less than its average variable cost. But Justice Dept. lawyers realized this would be almost impossible to do against American. Why? Because the airline industry, like high tech, has high fixed costs and low marginal costs. The big expense is buying equipment. Once a flight is scheduled, the marginal cost of providing a seat for an additional passenger is peanuts—plus a Coke, maybe.

tween Dallas and Kansas City, for instance, American's average one-way ticket was \$108

before low-cost startup Vanguard Airlines Inc. entered the market in early 1995. That prompted American to cut fares to \$80 and almost double the number of daily flights, to 14. When Vanguard gave up in December, 1995, American jacked up prices to \$147 and scaled back the number of flights. Justice lawyers even had memos from American execs plotting the upstarts' demise.

Alas, Judge Marten would have none of this. Unimpressed, he stuck



Just because you're good at one thing doesn't mean you're good at everything.

 Shaquille O'Neal was virtually a unanimous selection for Most Valuable Player in the NBA. But the skills that make him dominant in his line work don't ensure success in other endeavors.

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Shaquille O'Neal, NBA MVP

*Gartner Group, "Managed Web Hosting," January 2001. **SAS70 Type II recognition by Ernst & Young.

TAXES

HOW THE SUPER-RICH LUCKED OUT TWICE

New data show the top earners are already enjoying lower rates

Countless investors, small and large, made big gains from the remarkable stock market runup of the late 1990s. Some of those gains, of course, proved fleeting when the bubble burst. But the big winners were those who made truly monumental gains and managed to cash out in time, according to just released data from the Internal Revenue Service.

While wage and salary data on average Americans has long been readily available, figuring out how those at the top are faring has always been far trickier: They are few in number, and they guard their financial privacy closely. Now, however, the IRS has published data on the top 400 individual taxpayers—the super-elite, as ranked by their reported adjusted gross income. There are no names, of course. Still, the new data show just how much income these big earners made in the aggregate for each year from 1992 to 1998, how much they received in capital gains, and how much they paid in taxes.

WIDER GAP. The numbers tell a story of growing concentration of income at the very top. Including salary, dividends, interest, and capital gains, the share of income going to the top 400 individual taxpayers rose by two-thirds between 1995 and 1998, according to Joel B. Slemrod, a University of Michigan economist who analyzed the new data.

To put it another way, the average income for a member of this group rose from \$50 million in 1995 to a staggering \$110 million in 1998, an increase of 117%. Meanwhile, the average income for all tax payers rose from \$35,000 to \$43,000, an increase of 23%.

Even more striking, the

widening income gap between the top earners and the average American was accompanied by a falling average tax rate for the highest paid. In 1998, the top 400 taxpayers paid only 22% of their adjusted gross income in income taxes, way down from 30% in 1995. By comparison, the average tax rate paid by all taxpayers actually rose slightly over the same stretch, to almost 15%. This number, which measures the total income taxes paid as a share of adjusted gross income, averages out the effects of all tax deductions and exemptions and the lower rates paid on long-term capital gains, and also takes

into account the lower tax rates paid by many low-income households.

So why are tax rates for those at the top shrinking? Chalk it up to the lower rates paid on hefty capital gains. Most, but not all of the income increase at the very top came from capital gains. In 1995, they accounted for 44% of the income of the top 400; by 1998, capital gains brought in 73% of their income. For the average American, capital gains made up only 8% of income.

To be sure, the outside capital gains that helped boost the incomes and lower the average tax rates at the very top could well be transient. While likely to persist in 1999 and perhaps 2000, they could start to diminish as income tax returns reflect the bursting of the Nasdaq bubble.

PERMANENT LEAD? However long the effects of the boom last, the new numbers show that the amounts of money involved were enormous. In 1998, the last year for which data are available, the top 400 taxpayers received a total of \$44 billion, or nearly 1% of all income. By comparison, in each of the 17 states, including New Mexico and Hawaii, all state residents combined earn less than \$1 billion.

The experience of the top 400 is mirrored by less wealthy but still high-earning individuals. Take, for example, the taxpayers reporting more than \$500,000 in income. In 1998, this category included about 480,000 taxpayers, a mere drop from 125 million returns overall. Nevertheless, the group accounted for approximately 14% of income that year, up from 8% in 1995. Their average tax rate over that stretch fell from 31% to 28%.

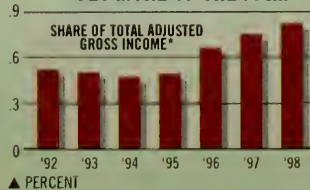
Will the income share of the top earners decline as the economy slows? Will their income grow faster than that of the average American? It's impossible to know. But it's clear that a relatively small number of individuals garnered a disproportionate share of the gains of the 1990s boom.

By Michael J. Ma...
in New York

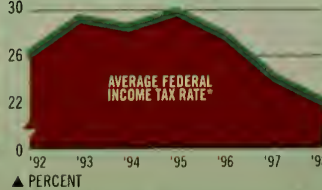


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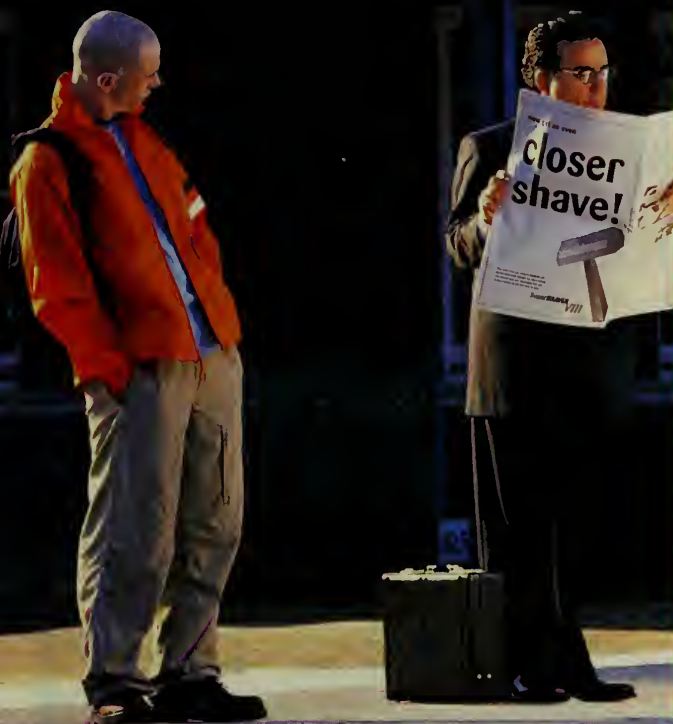
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Data: Internal Revenue Service, University of Michigan

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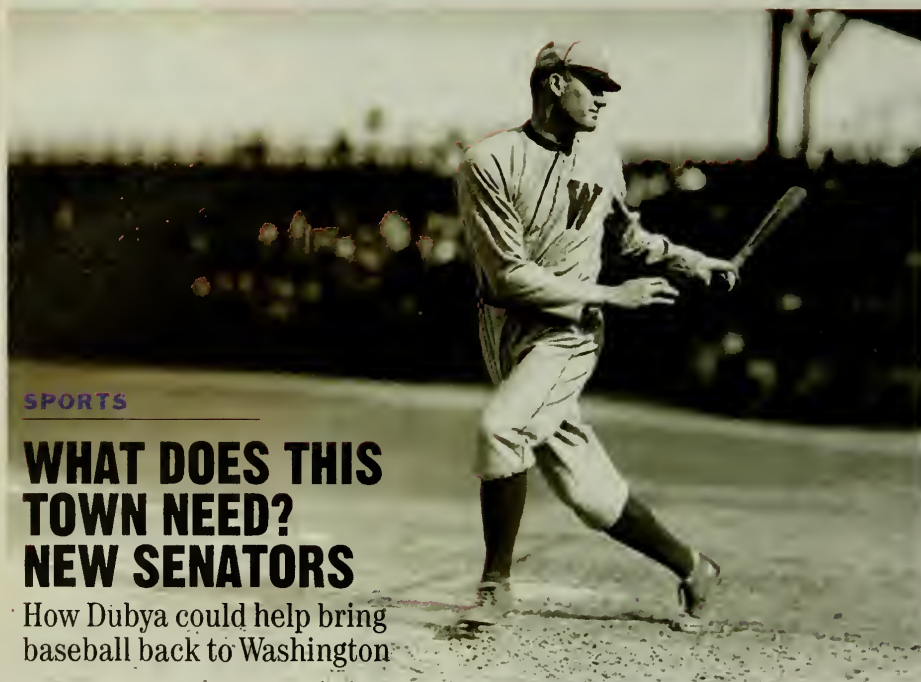
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GOOD OLD DAYS: *Legendary Senators pitcher Walter Johnson, circa 1920*

SPORTS

WHAT DOES THIS TOWN NEED? NEW SENATORS

How Dubya could help bring baseball back to Washington

It didn't take 100 days for George W. Bush to become the nation's No. 1 baseball fan. Already, Dubya has dined with Cal Ripken Jr. And on May 6, the President is set to inaugurate a kiddie T-ball diamond on the White House lawn.

But can the First Fan make what would be a startling catch for the nation's capital: a Major League Baseball franchise? Bush has indicated his desire to attend games in his new hometown, from which the Washington Senators fled in 1971 (to be reincarnated as the Texas Rangers, Dubya's old team). And by helping to bring back baseball, Bush could lend a hand to financier and family friend Frederic V. Malek—while punishing political foe and Baltimore Orioles owner Peter G. Angelos.

TRUE BELIEVER. Malek, ex-president of Marriott Hotels & Resorts and Northwest Airlines Corp.—as well as Bush the Elder's 1992 campaign manager—is a partner in Washington Baseball Club, a group that has been working since 1999 to land a franchise for D.C. The group, which also includes Fannie Mae Chief Executive Franklin D. Raines, America Online co-founder James V. Kimsey, and real estate developer Joseph Robert Jr., has had little success so far.

But Malek isn't discouraging speculation that prospects are brighter now that he has a powerful ally in the White House. "He believes in the city, and he believes in the game," Malek says of

the Prez. "He would like to expose foreign dignitaries who come here to the national pastime."

Others are inclined to Malek's rosy outlook. "If there are well-connected good old boys anxious to own a team in Washington, it pushes the whole thing along," says Andrew Zimbalist, a Smith College economics professor and author of *Baseball and Billions*.

Angelos, the feisty trial attorney who made his fortune in asbestos and tobacco litigation, stands to lose big if Malek succeeds. The Orioles owner has estimated that 25% of his customers come from nearby Washington and Northern Virginia, where a group competing with Malek's would like to locate a franchise. Malek disputes that number, but certainly the Birds might lose fans if another team pops up in their backyard.

In any case, sticking it to Angelos would be sweet payback for the noise he made during the Presidential campaign. A staunch Democrat, Angelos gave the party gifts totaling nearly \$1 million in the last election cycle. Angelos declined to comment for this article,

not to say they won't.

Even with a shove from the Oval Office, however, considerable roadblocks remain. Struggling franchises in Montreal and Oakland, Calif., have been moved to be on the auction block. And owners in Minnesota and South Florida have threatened moves if new luxury stadiums aren't built for their teams. But Major League Baseball requires three-fourths of its owners to approve any team relocation. And the lords of baseball haven't blessed a move since the Senators left to 30 years ago.



"[The President] believes in the city, and he believes in the game. He would like to expose foreign dignitaries who come here to the national pastime"
FRED MALEK

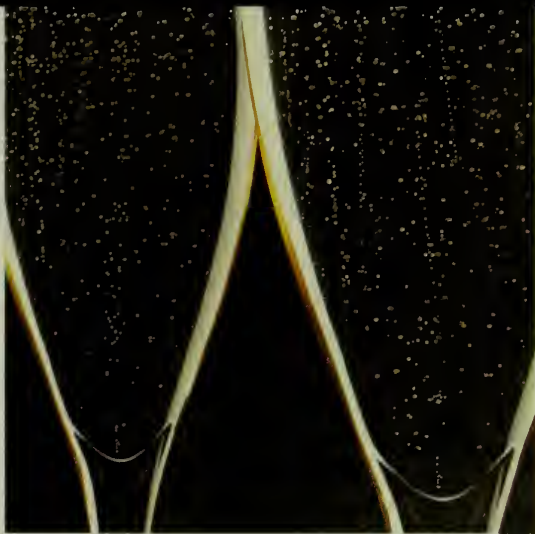
Franchise moves and elimination of weak teams through contraction—will be hot topics heading into negotiations with the players in October. Still, team owners are unlikely to tackle an issue as ticklish as relocation until a new deal is in hand. "Before then, it's not in their interests to do anything divisive among themselves," says Zimbalist.

Anyway, Fred Malek can afford to wait. He got the President waving up in the bullpen.

By Mark Hymowitz, Baltimore and Paul Dwyer in Washington

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EDITED BY MONICA ROMAN

GOING, GOING, GONE—TO TRIAL?

THE FORMER CHAIRMEN OF Sotheby's and Christie's International, two of the world's most renowned auction houses, were indicted on May 2 on a price-fixing charge. U.S. prosecutors in New York allege that shopping center magnate Alfred Taubman, who was head of Sotheby's from 1983 until early 2000, and Sir Anthony Tennant, Christie's boss from 1993 to 1996, conspired to rig commissions charged to sellers of art and other valuables. Taubman said he is "absolutely innocent" and says former Sotheby's CEO Diana Brooks acted alone. Brooks and Sotheby's have pleaded guilty. Tennant says he is "completely innocent of any involvement in price-fixing." Christie's is cooperating with

authorities. Both companies have agreed to pay \$512 million to settle civil lawsuits.

INTERMISSION TIME AT BMG

THE COLLAPSE OF MERGER plans with EMI Group because of antitrust hurdles leaves Bertelsmann CEO Thomas Middelhoff in a tough spot. Bertelsmann Music Group (BMG)—like EMI, one of five leading music companies—has lost market share. A merger between any of the five now seems impossible, so there's no obvious way for the German company to get bigger fast. There's speculation BMG will acquire an independent label. Another possibility: manufacturing and distribution alliances with rivals to cut costs without antitrust woes. Meanwhile, expect BMG to keep trying to solve the technical and legal problems holding up Net music sales.

CLOSING BELL

WHAT A PRICE

Priceline.com, left for dead by many dot-com investors, has roared back to life. Shares in the name-your-own-price company rose 44% on May 1 and 2, to \$6.96, after it reported a lower-than-expected loss of 3¢ a share for the first quarter. Slimmed down by layoffs, Priceline expects to hit its first operating profit this quarter. Still, analysts remain skeptical that the company's travel businesses hold big growth potential.



A BUMPY RIDE AT EVENFLO

THE CONSUMER PRODUCT Safety Commission and the National Highway Traffic Safety Administration announced on May 1 that Evenflo would recall 3.4 million Joyride infant car seats and carriers. There have been 240 reports of the combination product's handle unexpectedly releasing, causing the seat to flip forward. The Vandalia (Ohio) company will provide a free repair kit to help secure the handle of Joyride, which has caused 97 injuries. This is the latest recall involving failing handles on car seat and carrier products. Since 1998, four manufacturers have recalled nearly 10 million combination baby transportation products. More stringent industry standards that went into effect in February are designed to make the products safer.

HEADLINER: ALAN FELDMAN

MCDONALD'S JUST SUPERSIZED HIS ORDER

ALAN FELDMAN MAY HAVE thought his plate was full before at McDonald's. Now, his boss has just dished him up another task. Head of McDonald's U.S.A. since 1998, Feldman, 49, will become president on June 1 of the hamburger chain's Americas operations.



Feldman's promotion, announced on May 1, was part of a reshuffling by Chairman and CEO Jack Greenberg that saw the retirement of Big Mac's No. 2 man, Vice-Chairman and President James Cantalupo.

McDonald's has been battling slow growth during Feldman's tenure (page 77).

U.S. sales edged up 5% in the first quarter, after rising 3% in 2000. But operating margins have continued to slip. Analysts blame a new kitchen system for slowing service times. They also say that marketing tie-ins are no longer lifting sales.

Still, those domestic problems are nothing compared with Latin America, where currency devaluations and recessions routinely jinx results. Feldman might want an antacid with his new order.

By Michael Arndt

For more see the
MAY 1 DAILY BRIEFING
at www.businessweek.com

BETTER CHEMISTRY YIELDS PINK SLIPS

INCREASED SYNERGY MEANS A beaker full of layoff notices for employees at Dow Chemical and Union Carbide as they merge into a \$30 billion chemical giant. The No. 2 chemical maker is more than doubling its original estimate of \$500 million in savings from the merger with Union Carbide to \$1.1 billion by the end of the first quarter of 2003. To get those hefty savings, the Midland (Mich.) chemical company says it will trim 4,500 jobs at both Dow and Union Carbide—about 8% of its combined workforce and more than double original estimates.

YOU GOTTA HAVE A CATALOG

THE ONLINE TORTOISES ARE beating the pants off the e-hares. According to an annu-

al study of 550 Net retailers by Boston Consulting Group, catalog companies emerged as the only consistently profitable online retailers last year, thanks to cost advantages from private-label products and existing shipping capabilities. Of those selling online, 72% of mail-order outfits, 43% of store-based retailers, and 27% of Web-only e-tailers made money on an operating basis last year. Catalogers reaped the real benefits last year of the 66% rise in North American online sales to \$44.5 billion.

ET CETERA...

- PepsiCo handed the CEO and chairman's job to Steven Reinemund, as scheduled.
- MGM wants to raise its stake in four cable channels operated by Cablevision.
- Citigroup will offer eZit, an online money-transfer service, on Microsoft's MSN.

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BY LEE WALCZAK AND RICHARD S. DUNHAM

BUSH'S ACCIDENTAL, UNPREPARED, MUGELY SUCCESSFUL FIRST 100 DAYS

George W. Bush began his day on May 1 by delivering an address that made a cogent argument for his Star Wars antimissile shield—a plan foes deride as laser-powered pie in the sky. Then he called a Rose Garden press conference to unveil the “bad news” that Hill Republicans would fund only .25 trillion of his \$1.6 trillion tax cut. That’s 25% less than the Prez wanted, pundits were quick to note. But if Bush is in a losing streak, Democrats had better brace for four years of political irrelevancy. The emerging reality of the Bush Presidency is this: A leader who took office with few obvious political credits is beating expectations time and again.

Consider taxes. Because Bush held firm, the notion that the Senate Finance Committee hopes to complete within a week will be close to his blueprint. A new 10% bottom rate will be created to help the working poor. The child-care credit will be doubled. There will be relief for two-earner married couples. And the top rate will be slashed, not to Bush’s preferred 33%, but to the 35% range (vs. 39.6% now).

SINGULAR TRIUMPH. The major changes to Bush’s blueprint: Plans to kill the inheritance tax may be deferred, and the White House will accept a bill initiative to add \$100 billion in immediate tax relief. “Yesterday, people were debating whether there would or should be any tax relief at all,” says Budget Director Mitch Daniels. “Now we’re...splitting hairs.”

The tax fight represents a singular triumph for a supposed-hobbled President. It was accomplished with a combination of cunning, charm, message discipline, and the occasional karate chop. “Bush got 75% of what he wanted,” says John J. Pitney Jr., a Claremont McKenna College political scientist. “Given the circumstances under which he came to office, this represents very respectable progress.” Adds Dubya’s political guru, Karl Rove: “Bush knows when it’s time to deal.”

The President is also close to a deal on education reform.

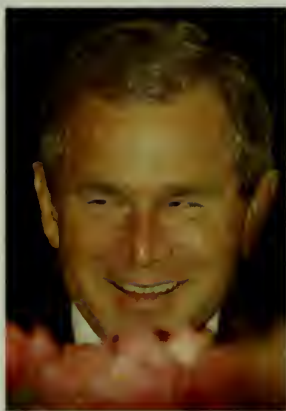
To hear Democrats tell it, Bush is in retreat, tossing school vouchers, spending restraint, and some of his grand visions for national testing over the side (page 84). In reality, when Congress agrees to a school-reform package that pumps billions into literacy programs and gives states new flexibility, the Prez will score another big victory. “Voters are comfy with moderate Republican governors who are good on education,” says Democratic pollster Celinda Lake. “Even Democrats give him good grades for reaching out on this issue.”

Watch for a tougher slog on the rest of Bush’s agenda. Vice-President Dick Cheney’s national energy plan, to be released soon, is tilted so far toward production incentives that Democrats will find it easy to add conservation measures to the package. The Administration’s early stance on environmental protection, which seemed hostile and depressed Bush’s popularity with independents, won’t help. Democrats weren’t able to use the class-warfare argument on taxes, but GOP pollster Edward Goeas says they may have more success “painting Bush as a tool of Big Oil” in the energy debate.

What about the defense overhaul Bush keeps promising? Experts say that if the Pentagon kills some big-ticket programs to make room for the \$7 billion Bush wants for Star Wars research, he can keep his commitment to the military and still come off as a reformer.

The President’s promise to revamp Medicare while helping seniors pay for prescription drugs is more problematic, lawmakers say: Even some Republicans consider his drug plan too puny. Likewise, the economic slump has taken a toll on Bush’s push for private Social Security accounts.

On balance, though, Bush’s performance, like the economy’s surprisingly resilient GDP numbers, continues to beat analyst projections. Democrats keep muttering that the Accidental President will soon be humbled. But thus far, Bush’s victories seem anything but accidental.



THE PREZ: On a roll

CAPITAL WRAPUP

SPEEDIER GENERICS?

With Congress deadlocked on a prescription drug benefit for seniors, lawmakers are seeking other ways to cut drug costs. On May 1, Senators John McCain (R-Ariz.) and Charles E. Schumer (D-N.Y.) introduced a bill that would make it harder for drugmakers to keep generics off the market when brand-name patents expire (page 78). Schumer figures the bill, which has support from everyone from Ford Motor and the AFL-CIO to hospi-

tals and insurers, could cut drug bills by \$71 billion over 10 years.

WEAKENING SECURITIES RULES

Republicans are taking aim at what they consider overly restrictive securities regulations. Senate Banking Committee Chairman Phil Gramm (R-Tex.) wants to revisit an SEC rule, effective last October, designed to prevent selective disclosure of market-sensitive information. He thinks it may slow the flow of info and contribute to market volatility.

RETIREES UNITE!

Fed up with employers slashing retiree health benefits at the same time they’re using huge pension surpluses to fatten bottom lines and boost CEO compensation, retirees are fighting back. More than 1.5 million retirees from companies such as Verizon, GE, and General Motors have formed the National Retiree Legislative Network. First order of business: push for a bill prohibiting reduction or curtailment of health benefits after a worker retires.

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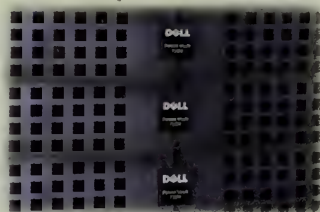
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SHIELD—OR RED FLAG?

The global debate intensifies

It could mark the biggest overhaul of U.S. strategic policy since the height of the cold war. It threatens to ruffle the feathers of America's European allies, strain relations with Moscow, and deepen a diplomatic conflict with China. And no one knows if the technology involved—sensors and missile-seeking warheads—will do the job.

Even so, President George W. Bush is determined to press ahead with plans to build a costly land-, sea-, and possibly space-based missile-defense system. It is aimed at protecting the U.S. and its allies from an attack by a small number of nuclear missiles launched by so-called rogue states such as Iraq or North Korea. "We need a framework that allows us to build missile defenses to counter the different threats of today's world," Bush declared on May 1 at the National Defense University in Washington. Ideally, Bush would like the first phase of his system to be up and running by the end of his first term, in 2004.

STRAW MAN? Bush's initiative is likely to intensify a fierce debate among America's friends and rivals alike over the effectiveness of a missile defense system. Up to now, leaders from Berlin to Seoul have raised red flags about missile defense because it clearly runs counter to the Anti-Ballistic Missile Treaty signed by the U.S. and the Soviet Union in 1972. That treaty severely limited defensive weapons, enshrined the doctrine of Mutually Assured Destruction, and kept nuclear peace for 30 years.

Russia and the Europeans have

been deeply worried about throwing the treaty out. Beijing is particularly incensed about missile defense because it believes the Bush Administration is slyly eyeing China as the key *raison d'être* for the system rather than North Korea or Iraq. "Many Chinese are suspicious that the real target is China. For the rogue states you don't need such a fancy system," objects Jia Qingguo, a professor of international relations at Beijing University. "China is definitely going to try to increase its strategic nuclear capabilities if the U.S. continues with this program," he adds. Administration officials deny China is the main reason for missile defense. But it's no secret that much of the Bush team sees China as a long-term threat to the U.S. "We don't want anyone, definitely including the Chinese, to be able to threaten limited strikes against the U.S.," says a senior Administration official. Coincidentally, on May 2, the Pentagon said that it would review all military contacts with China on a case-by-case basis.

With all the overseas opposition and the major technical risks (page 64), why is Bush so determined to go forward? Dig into the motives of the Administration and you'll see a powerful mix of opportunism and idealism at work.

Bush and the Republican right wing, missile defense is a goal that dates back to the era of Ronald Reagan in the 1980s. The popular President proposed a bold blueprint for space-based weapons to protect the U.S. from thousands of missiles from the Soviet Union. Technical problems kept the project from taking off, but many Republican hard-liners think the Reagan's Star Wars initiative helped break the Soviet Union economically and spur the changes that ended the cold war and triggered the collapse of what Reagan called the Evil Empire. Ever since then, building a defense shield over America has been a big item on the conservative agenda. "This is a litmus test of loyalty to Saint Ronald Reagan," says Lawrence J. Korb, vice-president of the

THE PROS AND CONS OF AMERICA'S MISSILE DEFENSE

WHY BUSH WANTS IT

THE THREAT

The Administration fears eventual nuclear attacks from so-called rogue states such as Iraq and North Korea, and accidental launches from China or Russia.



THE POLITICS

Making progress on Reagan's dream would boost Bush's reputation with conservatives while showing Americans he is doing his best to protect them.

Outgip the Gipper?

THE ECONOMICS

Defense contractors never recovered from the end of the cold war benefit from a big weapons program. European companies likely to lobby for it, which could cost \$100 billion.

While Putin and the Europeans are wary about junking the old treaty, the Chinese suspect they're the shield's real target

Council on Foreign Relations and a Reagan Administration Pentagon official, who believes missile defense systems aren't cost effective. "Bush has been under tremendous pressure to do something."

Beyond politics, there may be big gains for defense contractors. The project could cost from \$80 billion to \$120 billion over 25 years, according to government sources. Companies such as Boeing, Raytheon, and TRW have already been awarded contracts that could total \$13 billion.

Perhaps the most important driving force for missile defense, however, is that the Administration is filled with true believers. Officials such as Defense Secretary Donald H. Rumsfeld and his deputy, Paul D. Wolfowitz, are convinced that a shield is crucial to protecting the U.S.

A panel chaired by Rumsfeld in 1998 estimated that Iran and North Korea could have nuclear weapons and the ability to deliver them from afar in just a few years. If the U.S. puts up a shield, Administration officials contend, foes might pause before launching.

Of course, it could take more than a decade to develop an effective system. In the shorter term, the Administration hopes to use existing technologies to intercept enemy missiles right after take-off. The Administration has earmarked \$5 billion for research in 2002, but that is expected to grow to about \$10 billion annually by 2003.

Even more critical than technical work, however, could be the diplomacy needed to implement missile defense

without touching off a 21st Century version of the cold war. Bush is sending top envoys to Europe, Japan, and South Korea to explain his views. He's also courting Russian President Vladimir V. Putin, long an opponent of any initiative that could damage the ABM treaty.

Indeed, Bush is appealing to Putin to join with him to design a global security framework that would replace the ABM treaty. "Russia and the United States should work together to develop a new foundation for world peace and security in the 21st Century," Bush declared. To sweeten the deal, he plans to unilaterally cut America's nuclear arsenal, which now stands at about 7,000 warheads.

Putin has said Russia would be prepared to slash its arsenal from its level of 6,000 warheads to 1,500 as part of an arms agreement. Andrei Piontkovsky, director of Moscow's Strategic Studies Center, says Putin may now insist that Russia hold on to a greater number of warheads than the U.S. in return for agreeing to an American missile defense system to go ahead.

The Administration's efforts to engage Russia on missile defense are winning plaudits in Europe. "This is important. We don't want arms races," says Karsten D. Voigt, coordinator for German-American cooperation in the German foreign ministry. British Prime Minister Tony Blair is also reacting receptively to the Bush proposal. That's key, since Britain could be the site of radars necessary for the system.

NERVOUS NEIGHBORS. Bush's biggest diplomatic challenges will come from Asia. China is likely to fight the missile defense initiative fiercely because it worries that the U.S. may use it to defend Taiwan and thus encourage its independence. And the prospect of rising tensions in the region makes America's allies, Japan and South Korea, nervous. "China is right next door, so Japan must be careful about antagonizing its biggest neighbor," says Mataka Kamiya, an asso-

WHAT COULD GO WRONG

ARMS RACE

Missile defense could provoke Beijing into expanding its nuclear arsenal, prompting India, Pakistan, and perhaps Japan to beef up. Europeans are also worried about a new buildup.

STRAINED ALLIANCES

By overhauling the 1972 Anti-Ballistic Missile Treaty, the Administration would test relations with Russia and Europe.

China: The unspoken target?

TECH EFFECTS

A surge in R&D spending could widen the tech gap between the U.S. and NATO allies, making joint missions harder. It's also possible the system won't work.



PHOTOGRAPH OF BUSH BY KEN LAMBERT/AP/WIDE WORLD

ciate professor at Japan's National Defense Academy. Nonetheless, Japan is committed to spending up to \$250 million on a six-year research effort with Washington on a local missile shield.

Seoul is more concerned. "The scheme will antagonize both North Korea and China," worries Lee Jong Seok, a senior security expert at Sejong Institute, an independent security think tank in Seoul. "It will only touch

off a nasty arms race in Asia," he adds.

So far, the Bush Administration does not seem worried about that possibility. Indeed, Bush's initiative could be a ringing challenge to China not to test American supremacy in the Pacific. The implicit American threat: We can outspend you in any arms race you wish to launch. Meanwhile, Administration officials assert that the government has a moral obligation to use whatever technology it

can to protect innocent American civilians. "We must seek security based on more than the grim premise that we can destroy those who seek to destroy us," Bush declares. Perhaps. But the debate on how wise—let alone how moral—the new system is will go on for years.

By Stan Crock in Washington, with Mark Clifford in Hong Kong, Paul Starobin in Moscow, Rose Brady in New York, and bureau reports

COMMENTARY

By Stan Crock

IT'S ROCKET SCIENCE—AND THAT'S NOT GOOD

When a top State Dept. official recently told some Europeans about Bush Administration plans for missile defense, he made a revealing concession. He didn't claim that the new, scaled-back Stars Wars scheme would provide airtight protection against a handful of incoming missiles from a rogue state. Instead, the goal of a missile-defense system that would cost \$120 billion, he said, was to complicate "a prospective opponent's calculation of success, adding to his uncertainty and weakening his confidence."

There's a certain logic here. Compared with Ronald Reagan's Star Wars, President Bush's limited antimissile scheme seems more defensible morally: It aims to protect people rather than missile silos. It also has one technological edge. In theory, at least, it's easier to hit a few incoming missiles than to destroy the thousands of warheads that Reagan's version was designed to stop. **NO COPILOT.** However, the diplomat's admission highlights a critical flaw in the Bush team's game plan: While this downscaled missile defense may be feasible, it never will be reliable. Why not? Because tricky rocket and computer science are involved. Experts say an interceptor has a 70% chance, at best, of hitting an incoming missile. So the Bush team is counting on several opportunities to hit the missile—just after it's launched, in mid-course, and in its descent. But if each interceptor has a 70% chance of success, you never reach 100%. Supporters say that's better than no chance. But if the



TEST: Lots of software means lots of bugs

shield prompts China to expand its nuclear arsenal, and India and others follow suit, the net threat to the U.S. may grow.

In fact, launching missiles to knock out incoming warheads is a dicey proposition from the get-go. Aerospace leaders Boeing Co. and Lockheed Martin Corp. have lost plenty of rockets in lift-off, as have the Russians, the Europeans, and the Chinese. These projectiles aren't like ordinary planes, where a copilot takes over if the pilot passes out. In the language of complexity theory, rockets are "brittle"—one little thing goes wrong, and it's kaput. In last summer's test of the missile-defense system, a payload didn't separate

from the booster. That glitch wasn't even on the Pentagon's list of potential worries.

And think about the software involved. How long does your PC stay up without crashing? The programs required for missile defense will consist of millions of lines of code. They'll be vastly more complex than a Microsoft spreadsheet or Netscape browser. There is no perfect method to debug programs of that size.

While we struggle with these challenges, the very threats we seek to thwart may prove ephemeral. The regimes in Iran, Iraq, and North Korea could fade away or turn benign. China, on the other hand, is bound to expand its arsenal. It certainly won't stand by and let its small retaliatory capability be blunted by our defense system.

A NEW MAGINOT? What's more, as we spend ourselves into oblivion on mini-Star Wars, potential adversaries will turn the missile shield into a high-tech Maginot line. The shield won't defend us against cruise missiles or suitcase bombs. And however strong a missile-based system is, offensive weapons can easily overcome it. As proof, consider North Korea vs. the U.S. In one corner, a tiny, poverty-stricken country manages to come up with an arsenal of attack missiles. In the other, the world's most powerful country spends \$60 billion over 20 years and still lacks real defensive capability. Missile defense will raise the ante. But it won't alter any of the odds.

Crock covers defense from Washington



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CARMAKERS

MR. FIX-IT?

ALL SMILES:
SOME
INVESTORS,
HOWEVER,
ARE CALLING
FOR BLOOD



DaimlerChrysler's Rolf Eckrodt has only a short time to rev up sputtering Mitsubishi Motors

One of Rolf Eckrodt's first moves after arriving in Japan in January was to hand out fist-size chunks of the Berlin Wall. The recipients were the 25 highest officials at Mitsubishi Motors. Eckrodt, DaimlerChrysler's top troubleshooter, had labeled each piece "Leave no stone unturned." It was a not-so-subtle message that Eckrodt expected complete dedication to the job at hand: overhauling the ailing Tokyo carmaker—and vindicating DaimlerChrysler's \$2 billion investment. Yet weeks later, a dozen Mitsubishi Motors execs were sent packing, taking their rocks with them.

DaimlerChrysler's Mr. Fix-It is moving fast. He needs to, because turning Mitsubishi Motors around is going to be far more complicated than DaimlerChrysler anticipated. On May 18, the Japanese auto maker will report its worst earnings ever: pretax losses of \$750 million on sales of \$31 billion. This year, Mitsubishi Motors will be lucky to break even—and that's only if Eckrodt's hard decisions pay off.

If Toyota and Honda embody the

essence of Japanese excellence, then Mitsubishi Motors represents how much damage the Japanese can do to their top brands. The company, part of the huge Mitsubishi *keiretsu*, has traditionally counted on handouts from sister companies to avoid a cash crunch: The corporate coddling probably delayed restructuring too long. Meanwhile, Mitsubishi has stretched itself thin by competing in too many niches—while fielding few memorable models. This overreaching is partly responsible for the recent recall of 2 million glitch-plagued cars. Coordination with suppliers is inefficient, and cost controls are loose. No wonder Mitsubishi's sales in Japan have dropped 17% in the past six months (chart).

When DaimlerChrysler bought 34%

of Mitsubishi Motors last year, Stuttgart knew about the problems. Yet the Germans figured a standard restructuring job would make the deal worth it. The idea was that Japan's No. 4 auto maker, a proven force in Asia and, despite its problems, an accomplished builder of small and minivans, would complement DaimlerChrysler's solid footing in Europe and the U.S. As the automotive world's first global partnership, the DaimlerChrysler-Mitsubishi alliance was to be a test case for squeezing synergies from plants worldwide. DaimlerChrysler and Mitsubishi expected to cut costs by co-developing such new models as the "smart" minivan.

First, they will have to overhaul Japanese carmaker. To that end, Eckrodt and his team vow to cut purchases

MITSUBISHI'S WOES

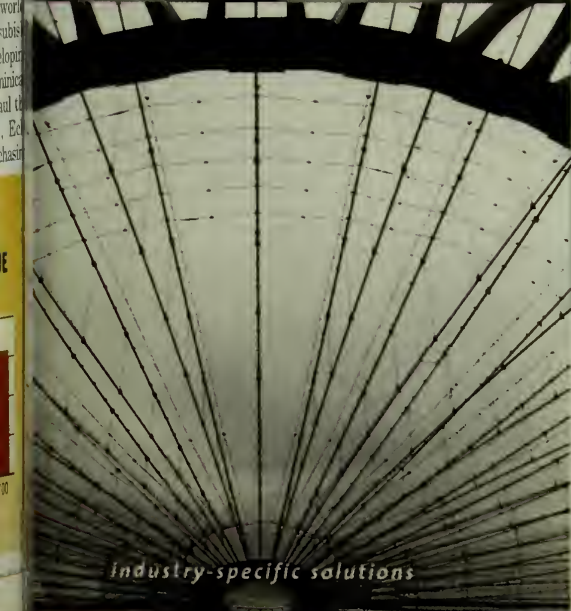




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costs by 15% over three years, slash 9,500 jobs, or 14% of the global workforce, halve the number of platforms from 12 to 6, and shrink domestic production capacity 20%. *BusinessWeek* has learned Eckrodt will go even further—dumping inefficient suppliers, cutting costs more aggressively, selling assets, and recasting the brand with a major ad campaign. Eckrodt is also likely to play a bigger role than he is willing to admit. So far, he has taken pains not to upstage his boss, Mitsubishi Motors President and CEO Takashi Sonobe. But the recent elevation of five of Eckrodt's aides to top posts indicates he will bypass Sonobe if restructuring falters.

LOW PROFILE. Like Carlos Ghosn, the former Renault exec charged with turning around Nissan Motors, Eckrodt went to Japan after restructuring other companies—in his case, Daimler's Brazilian subsidiary and rail affiliate Adtranz. There he earned a reputation for ruthless job-cutting and relentlessly squeezing suppliers, two skills that will come in handy at Mitsubishi. That's if Eckrodt's Japanese colleagues will let him. While Nissan's management was "ready to lay down their swords," says Christopher Richter, an analyst at HSBC Securities Inc. in Tokyo, "I don't think Mitsubishi is at that stage."

Indeed, Sonobe is no pushover. The Mitsubishi veteran won his job by sort-

UP AHEAD After streamlining Mitsubishi's network of parts suppliers, Eckrodt says he'll focus on brand-building and creating a more stylish lineup

ing out the U.S. operations, where, between 1998 and 2000, sales have surged 65%. "Sonobe led the turnaround in the U.S.," says Pierre Gagnon, chief operating officer of Mitsubishi Motors Sales of America Inc. "We think he can do the same in Japan."

But the company's latest setback—a recall involving 1.36 million cars—has apparently given Eckrodt room for some boardroom bloodletting. His Mar. 28 move to replace five top Japanese execs with Germans—four of them under 40—shocked company veterans. "I can't deny there were some misgivings among the rank and file," says a company source.

purchased to 20%. That's part of a drive to surpass the official goal of lopping 15% off overall expenses.

The moves plainly put Mitsubishi's suppliers at risk. Many next-generation models will share platforms with Chrysler, so suppliers must have the scale to meet demand for worldwide orders. Nor does being a longtime Mitsubishi supplier help. "There are no guarantees," says Sonobe, "only because it's a Mitsubishi company." That kind of talk unsettles Akikuni Itoh, who runs the money-losing supplier, Mitsubishi Automotive Techno-Metal Co. "Eckrodt is right about one thing," says Itoh. "If

CAR TALK



SEBRING LX

This \$20,000 Chrysler coupe shares a platform and engine with the Mitsubishi Eclipse and Galant

DIGNITY

The \$83,000 Mitsubishi limo was so pricey that it was discontinued after one year on the market



TOPPO

A hit at \$8,800, this minicar benefits from a Japanese fondness for engines smaller than 660 cc

"In Japan, it's pretty unusual to appoint thirtysomethings to senior posts."

Even more unsettling, the promotions coincided with the ouster of 11 of 38 senior Japanese executives. As Nissan's Ghosn says: "It's not the job title that matters. People inside a company know who's in control."

With his team in place, Eckrodt's first task is consolidating or getting rid of a third of Mitsubishi's 600-plus parts suppliers. The goal is to boost purchases from global suppliers—those who can provide parts to plants around the world—from the current 1% of all parts

[we] don't change, we'll be eaten alive."

Besides sorting out the suppliers, Eckrodt is betting on aggressive brand-building and a more stylish lineup. A domestic ad campaign starting this month will set the tone of a revitalized player. By October the company hopes to unveil at least one concept car under the direction of new design chief

Olivier Boulay, a DaimlerChrysler veteran who previously worked for Subaru in Japan. New models will probably adhere to Mitsubishi's traditional strength: small fuel-efficient cars and sports-utility vehicles aimed at entry-level buyers.

Can Eckrodt turn Mitsubishi Motors around? He worked wonders in the 1980s at Mercedes-Benz, where he pushed aggressive salesmanship instead of relying solely on great engineering to sell cars. At DaimlerChrysler's struggling Adtranz railroad unit, Eckrodt tracked individual and project performance on a monthly basis. He's bringing that concept to Mitsubishi as well—even impressing some senior executives of the Mitsubishi group. Among them, Minoru Makihara, chairman of traditional house Mitsubishi Corp. and de facto head of the *keiretsu*. Of Eckrodt, Makihara says: "He's able to come up with ideas I had difficulty getting out of Japanese management."

Still, squeezing out a profit over the next 12 months is a tall order for a company with a thin lineup but few new models, strong engineering but serious quality problems, and worldwide ambitions but familiarity with hitting global benchmarks of performance.

And if the plan doesn't show big savings and rejuvenated sales pretty quickly, the relationship between Eckrodt and Sonobe likely will be the first thing to collapse. The two have made a joint pledge to quit if the company does not break even in 12 months. Given the obstacles and potential for acrimony, either or the other could be out the door—much of the Berlin Wall in hand—well before then.

By Chester Dawson in Tokyo, with Jeff Green in Detroit, Larry Armstrong in Los Angeles, Christine Tierney in Frankfurt, and Jonathan Wheatley in São Paulo



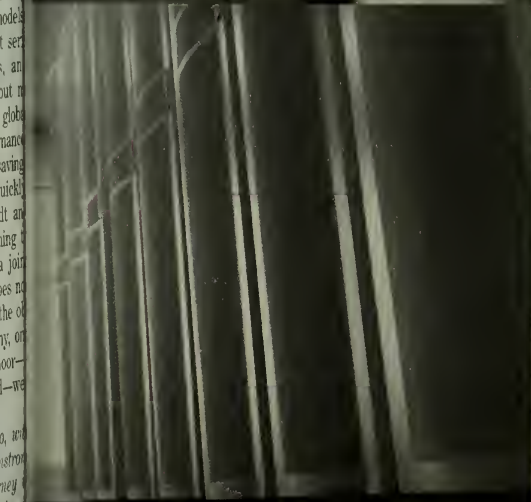
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JAPAN

CAN KOIZUMI'S TEAM KEEP HIM RIDING HIGH?

Some Cabinet picks may not share the leader's zeal for reform

The honeymoon almost every new national leader enjoys has so far been especially blissful for Japanese Prime Minister Junichiro Koizumi. Two separate polls taken after he appointed his relatively young and unusually eclectic Cabinet on Apr. 26 put his approval ratings at a remarkable 87%, far ahead of the previous record 72% scored by reformer Morihiro Hosokawa when he took office in 1993.

Hosokawa lasted only 10 months. Some Tokyo pessimists think Koizumi will be lucky to survive past September, when his Liberal Democratic Party holds its regularly scheduled presidential election. "His high popular support is heavy baggage," says Ikuo Kabashima, a political scientist at the University of Tokyo. "He has to satisfy high expectations, which will be difficult because the results of his policy will be bloody." Koizumi's recovery program includes massive economic restructuring, financial reform, and deregulation that could trigger a raft of bankruptcies, soaring unemployment, and recession. And on May 7, Koizumi was scheduled to make a major speech in which he would call for "structural reform without sanctuaries."

PUZZLES. How quickly Koizumi will push reform forward is still an open question, especially in light of some of his Cabinet selections. Most reassuring was the decision to reappoint Financial Policy State Minister Hakuo Yanagisawa, a hawk on the need to quickly clean up Japan's debt-ridden banks, which Koizumi has vowed to do within two years.

Koizumi's other choices for his finance team were more puzzling. For instance, he picked Taro Aso as the new chairman of the LDP's influential

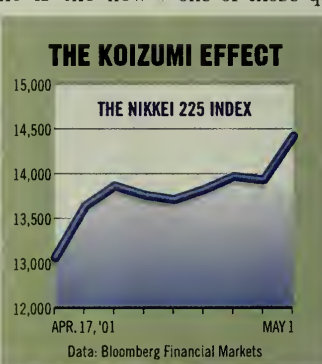
Policy Research Council. Aso, an LDP stalwart, has shown little of Koizumi's zeal for draconian reform and endorsed ex-Prime Minister Yoshiro Mori's policy of aggressive fiscal spending to right Japan's economy, which Koizumi opposes. Then there's Heizo Takenaka, an economics professor who is the new Economic, Fiscal, and Information Technology Policy State Minister. He has long called for a hike in the consumption tax to cut the fiscal deficit—an other policy that Koizumi opposes. Takenaka says he now endorses Koizumi's program. In a May 1 interview, he even called for a series of town meetings to get the

Japanese ready for severe austerity measures.

Finally, there is Finance Minister Masajuro Shiokawa, who holds potentially the most important Cabinet position. An LDP veteran and four-time Cabinet minister in other governments, Shiokawa has drawn fire both because of his advanced age—79—and his lack of experience in economic management. Indeed, Shiokawa kicked off his tenure by telling the press that he was "an economics expert." Shiokawa is also known for his record as favoring more fiscal stimulus and other discredited programs of the Mori government.

Yet Shiokawa may yet prove to be one of those quiet fixers that Japanese

politics occasionally produces—a party insider who uses connections to get the hard stuff done and most controversial bills through the Diet. As Transport Minister in 1980, he managed the politically tricky task of selling off some of the government's stake in Japan National Airways. Shiokawa also got good marks at the



INSIDER: Finance Minister Shiokawa admits he is "no economic expert," but he could be a political fixer

Group of Seven conference of finance ministers in Washington in late April. He "was really quite forthcoming and forceful in indicating the full intent of the new Japanese government to move forward" on reform, U.S. Treasury Secretary Paul O'Neill told the press.

TENSIONS AHEAD? U.S. officials were also gratified by Koizumi's proposal to allow the Japanese military to play a greater role in the "collective defense of Asia. And international investors have already voted aye on his promise of fast reform. The depressed Nikkei stock index jumped sharply in the days after Koizumi's election (chart). "From now until the Upper House elections at the end of July, we believe investors will continue to give the benefit of the doubt to the Japanese government," says Kathy Matsui, chief strategist at Goldman Sachs (Japan) Ltd.

She's not so optimistic for the long term. Koizumi's popularity could give the LDP a victory in the elections, Matsui says. After that, "tensions dividing the reformers from the anti-reformers in the LDP" will make legislating change more difficult. That may be, but for the moment, Junichiro Koizumi has the kind of momentum every politician wants.

By Robert N. Johnson
in Tokyo

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MILLER'S GENUINE DROUGHT

Even an elite SWAT team can't boost sales

As the long hot summer approaches, few are as thirsty as the managers heading up Miller Brewing Co. The elite team was parachuted in by parent company Philip Morris Cos. to fix years of flagging sales and dwindling market share at the nation's second-largest brewer. But after two years, the taps are still running dry. Philip Morris recently reported a disastrous first quarter for Miller, with income plunging 18.4%, to \$124 million, on a 5.1% decline in volume, to \$991 million.

Wholesalers, ad execs, and former managers say that Miller CEO John D. Bowlin and his team of beer-industry novices have had a hard time getting the hang of the beer market. Meanwhile, they are facing strengthened domestic

rivals at a time when a long-running beer boom, sparked by a healthy economy and a demographic spike in legal-age drinkers, may be sputtering to a stop. Compounding the problems, Bowlin and company fumbled a pair of import brands that might have given Miller a leg up on nemesis Anheuser-Busch Cos. The result: They've been unable to stem a slide that has knocked down Miller's share of the U.S. market from 22.9% to 20.5% over the past five years.

There may be an extra incentive to get it right at Miller these days. Analysts



believe that Philip Morris could be preparing its beer unit for spin-off or sale, perhaps to an expansion-minded foreign brewer or No. 1 domestic player Adolph Coors Co. Although Philip Morris has been unequivocal in its support of Miller, that could change once a planned initial public offering of its thriving Kraft unit is completed in June. A spin-off of the remaining 80% should follow, leaving Philip Morris overwhelmingly a tobacco company. Because of the huge capital gains a sale would generate, many believe a Kraft type spin-off is in the cards for Miller. "I see a spin-off down the line, but because of tax issues I doubt a sale," says Caroline S. Lev

an analyst with UBS Warburg LLC.

WITLESS ADS. When Bowlin and his handpicked team from Kraft and Marboro arrived at Miller's Milwaukee headquarters, the former Kraft CEO promised "world-class" advertising for the slumping Miller Lite and Miller Genuine Draft brands. Help from some master brand builders was just what Miller needed.

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udweiser's talking lizards and time-
 -sted Clydesdales were clean-
 -g Miller's clock. "You
 -atch some of the Bud
 -ls and ask yourself,
 -ow hard is this
 -uff?" laments a ma-
 -r-market Miller wholesaler. But
 -stead of the breezy wit of-
 -red by its rival, Miller and
 -ie agencies brought in
 -om the Kraft roster re-
 -orted to nudity, gross
 -umor, and wrong-
 -eaded settings such
 -a hospital materni-
 -ward. Beer-drink-
 -g younger



males were drawn instead to
 Bud's new "Whassup" ads.

Why has it
 been so hard for
 the Miller team to
 get the formula right?

For starters, aside from Bowl-
 in, who put in a stint at Miller
 in the mid-1990s, they had lit-
 tle beer experience. For
 marketers used to pitching
 Kraft mac-and-cheese
 to moms or Marlboro
 cigarettes without TV,

it proved a steeper-than-
 expected learning curve.

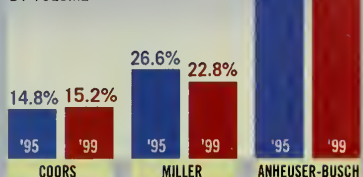
"Early on it was clearly slower," acknowledges Robert L.
 Mikulay, senior vice-president
 for marketing. "We and the
 agencies needed to hit our
 stride." Bowlin compounded
 the problem by harping on his

goal of "world-class" advertising, set-
 ting unrealistic expectations. That phrase
 now is verboten within Miller.

SUMMER MAGIC? There have been other
 problems. At a time when imports were
 enjoying double-digit sales gains, Miller's
 rights to Canada's Molson and Australia's
 Foster's should have conferred a rare
 edge over Anheuser-Busch, which offers
 no significant imports. But Bowlin's team
 couldn't pull Molson out of a prolonged

WHERE THE SUDS ARE

SHARE OF U.S. PREMIUM
 BEER SHIPMENTS,
 BY VOLUME



Data: BusinessWeek, calculated from Impact data

skid, even as it underspent on the
 healthy Foster's brand. Molson subse-
 quently bolted to Coors.

As another summer selling season
 approaches, there have been some hope-
 ful signs. Last week, Miller unveiled to
 4,000 wholesalers new ads that humor-
 ously skewer courtship and male bond-
 ing rituals and celebrate the brewery's
 heritage. While there weren't any
 Whassup-type vows, many felt that the
 new ads showed marked improvement.
 Now, with the ad budget getting juiced
 by 20%, to nearly \$300 million, Miller
 hopes to regain lost ground. Even just
 a point of recouped share might help
 slake the thirst of the Miller team—
 and add to the price Miller Brewing
 might fetch in a sale.

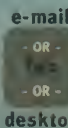
By Gerry Khermouch in New York

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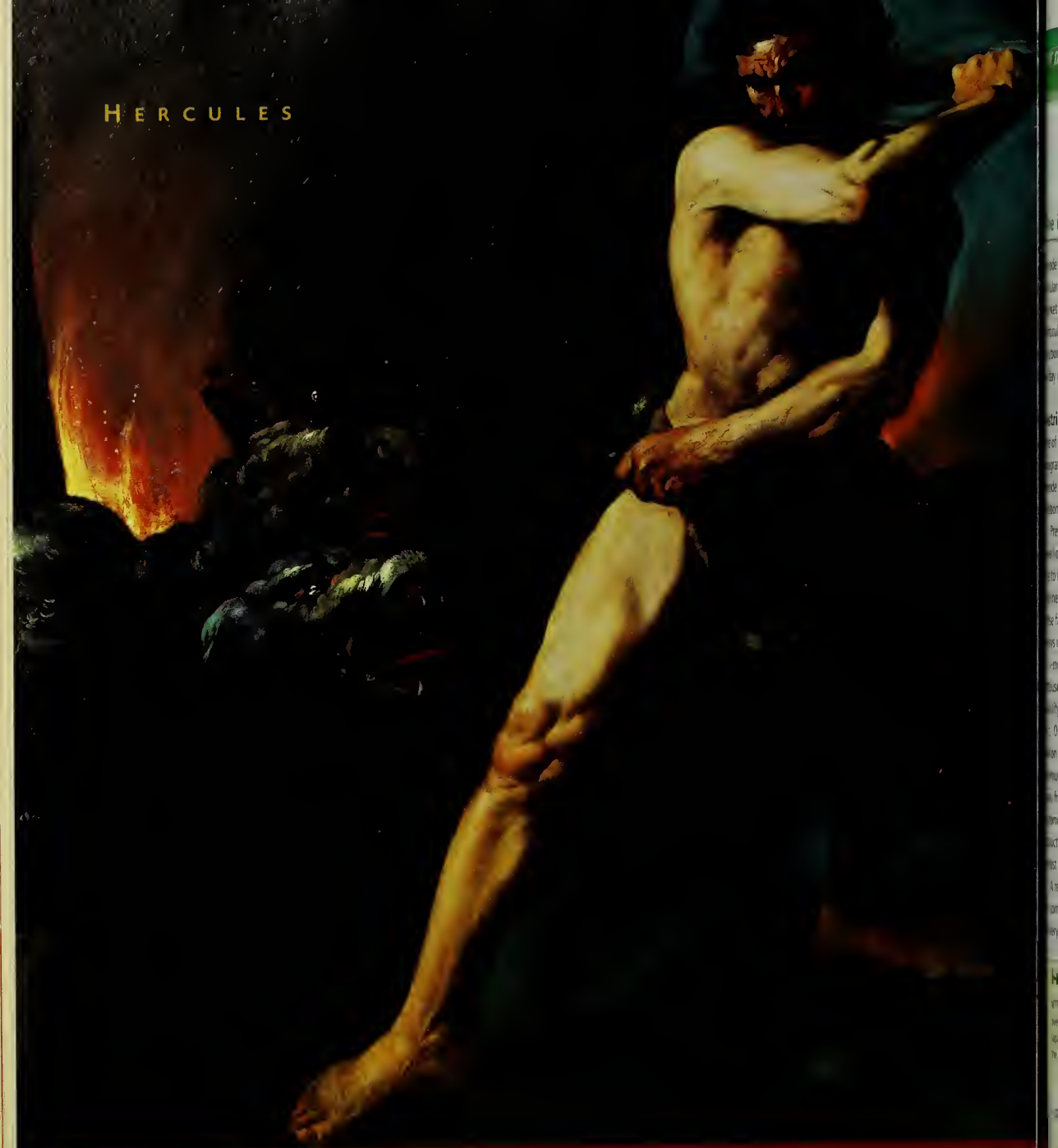
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i-mode is taking the business world by storm.

The i-mode business solution

i-mode has literally transformed the Japanese cellular landscape, creating a burgeoning new market for mobile multimedia services. Particularly in the business world, i-mode based solutions are having a significant impact on day-to-day operations.

Distribution industry

One of Japan's leading companies in the field of integrated distribution services has turned to mode in its efforts to improve customer relations.

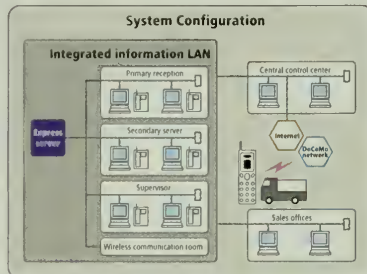
Previously, the company employed vehicle-based communication systems that were expensive to replace, limited to voice transmission, and ineffective when drivers left the vehicles. These factors often contributed to unacceptable delays in responding to customer requests.

i-mode captured the company's attention because of its small initial investment, superior mobility, and ability to transmit both images and text. Once integrated into the company's information system, it allowed customer centers to communicate directly with drivers — even when away from their vehicles. Moreover, precise customer details and collection-and-delivery instructions could be relayed and shared with utmost reliability via visual data.

A resounding success, the system has given the company an edge over the competition in delivery efficiency and customer satisfaction. It

has also sped the development of additional sales functions for the company's truck drivers.

Anticipating still further improvements in the quality of its services, the company is now adding new i-mode based services for package inquiries, delivery completion e-mail, and delivery receipt certificate requests.



Sales industry

A major sportswear company in Japan that operates over 300 outlets throughout the archipelago is another example of a business that has benefited from i-mode.

In the past, the company's salespeople submitted sales reports and customer feedback via fax, requiring secretaries at the head office to type the information into a company database. It was a time-consuming process prone to errors and delays.

Since April of last year, however, over 600 of its sales coordinators have been equipped with compact i-mode phone terminals from which up-

to-the-minute information is directly transmitted to a company Web site.

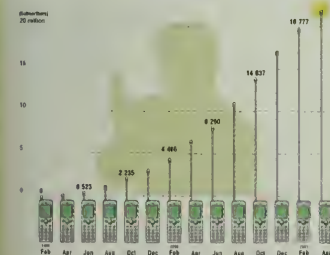
Available to all personnel nationwide, whether in the field or the office, the company site helps keep everyone equally informed and enables more knowledgeable decisions ASAP. According to a company spokesman, the potent combination of i-mode and the company Web site is painting a more accurate picture of market conditions and contributing to the company's development of a more effective branding strategy.



i-mode in Japan

NTT DoCoMo's i-mode cellular service has attracted over 22 million subscribers since its introduction in Japan in February 1999, accounting for over 60% of the company's total 36 million subscribers.

With the press of a button, users can access over



i-mode's meteoric rise continues unabated. By the 8th of April, the service had attracted over 22 million Japanese subscribers.

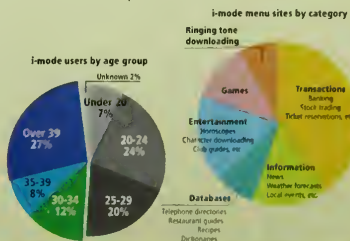
1,600 i-mode menu sites and 40,000 voluntary sites and use specialized services that range from e-mail, online shopping, ticket reservations and databases to news, entertainment and transactions with numerous Japanese banks.

i-mode content is based on a subset of HTML, the world's de facto scripting language. This makes conversion from Internet content a remarkably simple process for content providers.

DoCoMo also caters to user demands with reasonable fees. Through the advanced packet transmission system of NTT DoCoMo, users are charged for volume of data received, rather than time spent online. This promotes longer, more frequent visits. In fact, over 90% of i-mode subscribers are active users, accessing an average of 11 sites per day.

The clarity of DoCoMo's vision has been critical to i-mode's success. When the service was launched in 1999, many believed there was little room for growth in Japan's nearly saturated mobile phone market. But DoCoMo's confidence that data traffic would open up new business avenues was clearly justified.

Thanks to NTT DoCoMo's technological leadership and win-win relationships with content providers and phone vendors, i-mode keeps evolving by leaps and bounds. New Java capabilities, for example, allow users to download applets, receive automatic updates on weather, stock prices, company appointments and more. When the high-speed multimedia power of 3G arrives — through FOMA, the world's first third-generation mobile service — there will be no end to i-mode's business possibilities.



i-mode is the name used in Japan for NTT DoCoMo's mobile internet service. FOMA (Freedom Of Mobile multimedia Access) is the name used in Japan for NTT DoCoMo W-CDMA services.

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HERE'S LIFE IN THE OLD BIRD YET

Boston Market is back from the brink, and it's helping boost McDonald's sagging bottom line



LOGGING IN: President Andres and Chairman Kindler

Just five years after its 1993 initial public offering, the chickens came home to roost at Boston Market when the home-style eatery—a victim of overexpansion—declared bankruptcy. Last May, McDonald's Corp. swooped down and snapped up the carcass for only \$173.5 million, planning to scrap the chain and convert its 860 stores to more burger places or outlets of McDonald's new pizza and burrito chains.

But a funny thing happened to Boston Market on the way to the scrap heap. Although the man McDonald's brought in to rescue Boston Market, former General Electric Co. chief litigator Jeffrey B. Kindler, swiftly shut 100 stores and earmarked 50 or 60 more for conversion, he also became convinced that Boston Mar-

ket had a future. Internal marketing data showed that the chain had a surprisingly loyal customer base. Plus management had developed good ideas for new entrees, such as grilled chicken. "We were sold on the brand," says Kindler, Boston Market's chairman.

The clincher was a ten-year pact negotiated with Heinz Frozen Food Co. to put the Boston Market name on a line of frozen dinners for 10 years. Even with the restaurants in bankruptcy, Heinz discovered in surveys that consumers were 30% more likely to try the new entrees if they carried the

Boston Market logo over any other name it tested. The supermarket line is now a \$100 million business. "It's a great brand name," says Neil Harrison, Heinz Frozen Food's president.

Now Kindler has bolder plans. He is remodeling stores across the country and even plans to open new ones—a remarkable comeback for a chain written off as dead.

A LITTLE LUCK. Maybe McDonald's has finally found a winner in its search for life beyond burgers. Since 1998, the fast-food kingpin has acquired a handful of restaurant chains to make up for its stalled growth. But the company concedes that its two biggest acquisitions, Donatos Pizza, with 166 outlets, and

Chipotle Mexican Grill, with 124, are still losing money. And

three other additions—two

restaurant outfits in London and a stake in an online meal-delivery site—are too small to matter much to a company with \$14.2 billion in annual sales and 28,900 outlets. "Developing new concepts is not something they are necessarily adept at," scolds Timothy M. Ghisric, a portfolio manager at Dreyfus Corp., which holds 2.8 million McDonald's shares.

Boston Market, however, may be different. With 702

company-owned stores in the U.S., the roasted chicken and meat-loaf chain has since last May posted year-on-year sales increases of 7% to 8% every month, while domestic sales at traditional McDonald's grew only 3% to 4%. Thanks to these outsized increases, Boston Market now grosses more than \$700 million a year, says Kindler.

McDonald's is guarded about Boston



AN UNLIKELY SUCCESS

A year after buying it for the real estate, McDonald's is eyeing the chain for expansion. Here's a snapshot of Boston Market:

ANNUALIZED SALES \$700 million (up 8% from last year)

OUTLETS 702 (down from 860 last year)

BEST-SELLING ITEMS Rotisserie chicken, meat loaf

AVERAGE CHECK \$9.60 a person, vs. \$4.75 for McDonald's

Data: McDonald's, Technomic Inc.

Market's numbers. Kindler says the chain has been consistently profitable, but he won't give out specifics. And McDonald's has shown its faith in Boston Market by assigning an experienced senior vice-president, Michael D. Andres, to be Kindler's right-hand man and president. Analyst Janice L. Meyer of Credit Suisse First Boston figures Boston Market lifts McDonald's annual per-share earnings by maybe 2¢. By itself, that can't offset McDonald's earnings slump: First-quarter income fell 16%, to \$378 million, or 29¢ a share, from 33¢. That was on a measly 5% sales increase. But Meyer says: "They could use every penny they can get."

"NOT GREASY." McDonald's execs cite test results at four Tucson stores that reopened in October as proof of Boston Market's potential. Back in business with a warmer decor, expanded menu, and renewed marketing push, monthly sales have grown by 15% or more. McDonald's now plans to refashion the entire chain along those lines by early 2003. It says that it will even consider opening new Boston Markets in a few years, both here and abroad. Beyond that, Kindler's team is trying other ideas to boost earnings, including a greater emphasis on catering and accepting phone orders in some markets. Kindler may also test home-delivery service next year. Add it all up, and he sees double-digit annual sales growth for the next three years.

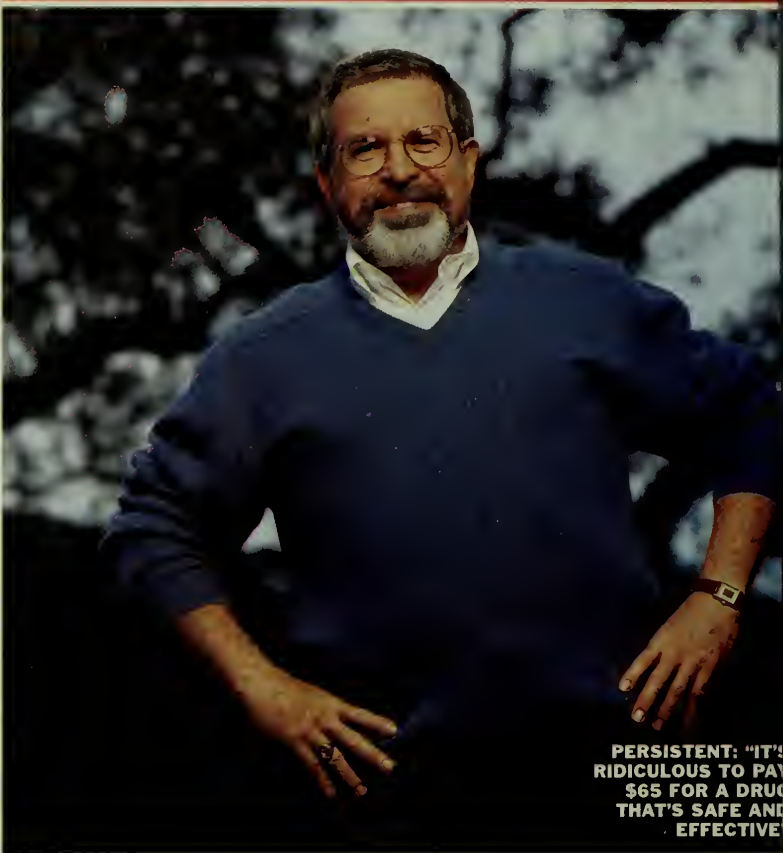
Swing by one of those new Tucson restaurants, and you see the new Boston Market in action. Schoolteacher Randall Smith stops by once a week to pick up dinner. Tonight, he's happy with his barbecued chicken takeout. "It's inexpensive. It seems healthy. And it's not greasy fast food," he says. Sounds like another convert from the ranks of the burger crowd. But this time, the biggest burger chain of all is more than happy to hear about it.

*By Michael Arndt
in Tucson*



REDESIGNED: A warmer setting

People



PERSISTENT: "IT'S RIDICULOUS TO PAY \$65 FOR A DRUG THAT'S SAFE AND EFFECTIVE"

COST-CUTTERS

LEONARD THE GIANT KILLER?

WellPoint's Schaeffer is taking on drug behemoths to make more medications available over the counter

At 5 feet 7 inches, Leonard D. Schaeffer often makes jokes about his own height. The CEO of insurer WellPoint Health Networks Inc. came back from the Academy Awards awards last year delighted to report that actor Tom Cruise is even shorter than he is.

Nevertheless, Schaeffer is not one to back away from big adversaries, and he's about to take on some doozies: the Food & Drug Administration and three

leading pharmaceutical companies. On May 11, the FDA will hold a hearing to discuss WellPoint's petition to make two allergy medications Claritin, Allegra, and Zyrtec available over the counter. The makers of those blockbuster drugs say they'll fight Schaeffer tooth and nail, but he's undeterred. He figures the change would save his company \$90 million a year in drug costs and unnecessary doctor visits. "It's ridiculous to pay \$65 for a drug that's safe and effective," Schaeffer says. "I think the FDA will take this seriously."

PINCHPENNY. WellPoint's FDA petition is novel, to say the least: It's the first time a request for over-the-counter status has come from an insurance company. But it's only the latest example of t



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management style Schaeffer has employed to prolong one of his industry's most consistent winning streaks. While other big health-care companies have stumbled after seeking growth through rapid-fire acquisitions, Schaeffer kept a focus on cutting costs and finding more flexible pricing plans. He avoided the leap into Medicare coverage that troubled PacificCare Health Systems Inc. and other health-maintenance organizations after the federal government stopped reimbursements in 1997.

The payoff: In the past four years, the Thousand Oaks (Calif.) health insurer, the nation's fourth-largest, has charted annual operating-earnings growth rates between 9% and 15%. John Szabo, an analyst at CIBC World Markets, expects WellPoint's operating earnings to grow 21% this year, to \$714.7 million, on 34% higher revenues of \$12.4 billion, partly due to its 2000 acquisition of Cerulean Inc. Wall Street has noticed, too, sending the stock up 38% in the past 12 months, to about \$100.

But keeping up the momentum won't be easy. Schaeffer's extreme focus on the bottom line has sparked a backlash among California doctors, many of whom call WellPoint "the blue shaft"—a jab at its Blue Cross of California plan—and claim it isn't reimbursing them enough to cover their costs. "Doctors feel severe animosity toward [Schaeffer] because he's undermining their efforts to provide good patient care," says Jack Lewin, CEO of the California Medical Assn.

BEING RED. Schaeffer, 55, has raised the hackles of Schering-Plough, Aventis, and Pfizer—makers of Claritin, Allegra, and Zyrtec, respectively. Previously, only drug companies petitioned the FDA for a switch, and the companies conceded it can't be made without their permission. But WellPoint looked at the doctors the agency has traditionally concurred and marshaled research that it supports its case—including manufacturers' own ads. Says Schaeffer: "Where we have drugs that the drug companies say are extremely effective, with few side effects. But you have to have a doctor's appointment and a prescription to get them." Schering replies that by giving the drugs wider distribution, WellPoint would threaten optimal patient care just to cut costs. "Allergic disorders are complex and often associated with more serious conditions, such as asthma," says William O'Donnell, Schering spokesman.

Blue Cross of California was itself in for health, losing \$165 million a year,

when Schaeffer took over in 1986. He restructured, cutting 3,000 employees and organizing the rest by customer segment—individuals, small companies, large companies—rather than by job functions. Then he encouraged each unit to devise innovative "hybrid" products that would be as affordable for employ-

LEONARD D. SCHAEFFER



BORN July 28, 1945, Chicago

EDUCATION B.A., economics, Princeton University, 1969

CURRENT JOB Chairman & CEO, WellPoint Health Networks

GOVERNMENT WORK Director of the Illinois Bureau of the Budget from 1975 to 1976; administrator of the U.S. Health Care Financing Administration under President Carter

HIS START IN HEALTH CARE At age 13, he was an apprentice for his father, a pharmacist

BIGGEST CHALLENGE Soaring drug costs; prescription allergy medicines alone cost WellPoint \$90 million a year

FAVORITE STRESS

RELIEVER Hot-air ballooning with wife, Pamela, and their two grown children



ers as an HMO but would offer more flexibility for members. That led to such plans as FamilyElect, which lets employees choose a different medical policy for each member of their families. The more flexibility members want, the more they pay. Today, less than a third of WellPoint's members are in traditional HMOs. And while most health plans guarantee a fixed premium for 12 months, WellPoint's contracts allow it to hike rates at any time for individuals and small businesses, with 60 days' notice.

The innovations emanate from a management style Schaeffer calls "loose-tight." He requires every manager to devise three-year and one-year plans, complete with monthly goals, and to report progress on WellPoint's intranet. Schaeffer is known to be unforgiving with managers who miss their goals, but he takes a hands-off stance with those who hit them. "He makes the planning process very time-intensive and regimented," says

Deborah F. Lachman, senior vice-president for the Individual & Small-Group Div. "Yet he gives us freedom to be bold and creative."

"ALPHA MALE." And there's nothing Schaeffer loves more than stirring the pot. "He's the alpha male of the health-care industry," says Nancy Chockley, president of the National Institute for Health Care Management Research & Educational Foundation, a think tank that Schaeffer

chairs. "If he detects any sort of power vacuum in the room, he fills it," she says.

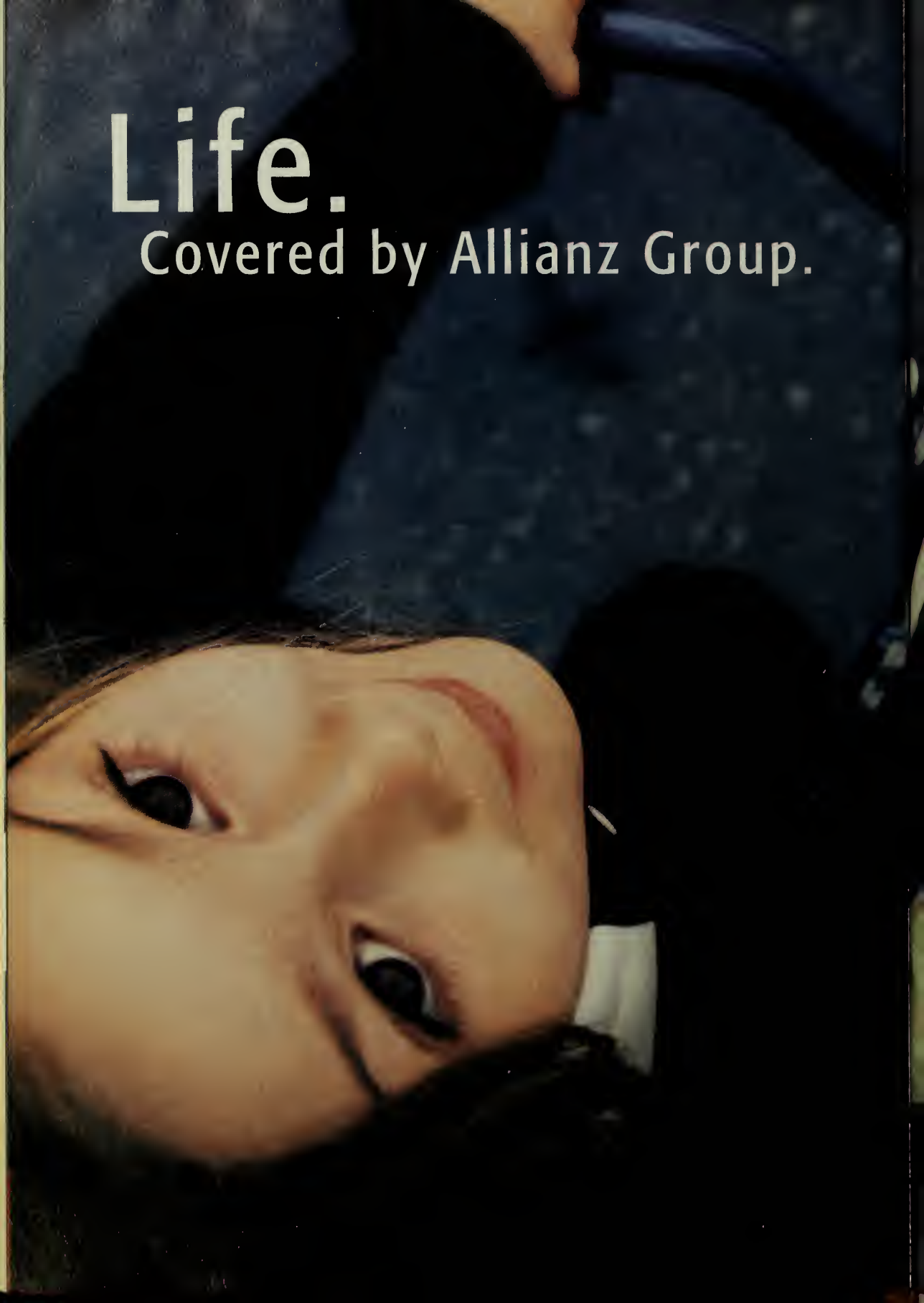
Still, by taking on the drug companies—and the FDA—WellPoint is in for a long battle, at best. No one knows this better than Schaeffer, who has first-hand experience with bureaucracy. At 30, the Princeton economics grad rose to become budget director of Illinois. Schaeffer took an aggressive approach to controlling debt: "We either had to raise taxes or reduce spending, so I cut all kinds of unnecessary crap—cars, airplanes. The state of Illinois had nearly as large an air force as Israel."

Later, as an assistant during the 1970s to Joseph Califano Jr., Secretary of Health, Education & Welfare, Schaeffer was put in charge of combining Medicare and Medicaid into one agency. He had to persuade state officials

to take efficiency steps such as cutting the days a mother on Medicaid stayed in the hospital after having a baby. The job "took a combination of schmoozing and cajoling," says Califano, now chairman of the National Center on Addiction & Substance Abuse.

These days, Schaeffer takes his mind off rising health-care costs by going hot-air ballooning with his wife, Pamela, and their two grown children. On one trip in Africa, he recalls, "we had prides of lions and herds of giraffes running in front of the balloon. It was fantastic." Then it was back to earth, where Schaeffer is sprinting to stay one step ahead of an equally determined herd of drug companies and doctors.

By Arlene Weintraub in Los Angeles

A close-up, low-angle shot of a woman driving a car. She is looking upwards with a slight smile, her face partially in shadow. The background is a dark, textured surface, likely the car's interior or a night scene.

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EDUCATION

THE SHAPE OF SCHOOL REFORM



Some pieces of Bush's plan are getting left behind—but the President is likely to get most of what he wants

Everyone is for education reform, but defining "reform" is another matter—especially in Washington. For weeks, Republicans and Democrats have been divided, whether it's over how to interpret standardized test scores or how much to spend on school construction. President Bush has

staked enormous political capital on his plan to "leave no child behind," a top domestic policy issue in the campaign.

As the Senate debated his plan in the first week of May, lawmakers were close to a deal. Bush is sure to lose on one key issue—the hot-button question of vouchers. Democrats also have forced Bush to go along with more spending than he wanted. But when the dust settles—which should happen this spring—he's likely to emerge with most of his agenda intact. If so, it would help shore up his image as a "compassionate conservative."

A guide to the key issues follows:

TESTING A Bush win. States will be forced to test reading and math in grades 3-8.

ACCOUNTABILITY Another win. Schools that fail to meet goals in five years must restructure or become charter schools. Those in failing schools will be allowed to transfer to another public school.

VOUCHERS Bush loses on letting students use public funds to attend private schools.

How would Bush's education reform affect schools?

His plan would require schools to give standardized reading and math tests every year, beginning in 2004. Every student in grades 3 through 8 would be tested. Individual school districts would be required to improve their test scores every year.

If they don't, the Education Dept. could withhold federal money, which makes up about 7% of school spending nationwide. Failing schools could be dismantled or turned into charter schools. Parents also would get more say in which schools their children attend.

So what has been dividing Democrats and Republicans?

Lawmakers agree in principle that schools need to measure student progress. They also agree that it's high time problem schools were forced to face up to their failings. But the two sides have been at odds on how much money the federal government should pitch in.

How are they bridging the gap?

They compromised. Initially the President proposed a hike of 5%, or \$1.8 billion, which would lift federal spending on K-12 education in 2002 to \$19.1 billion. By May 1, the White House, under pressure from Democrats, had come up to more than \$23 billion. For their part, the Democrats, who want more money to repair schools and hire teachers, came down from \$31 billion.

Why do Republicans oppose more funds for schools?

They argue that the feds have already ponied up education money for the states in past years with little to show for it. Federal spending on schools has more than tripled since 1982, to \$17.2 billion, yet student math and reading scores have remained flat. So Re-

But students in poor districts will be able to use federal dollars for private tutoring.

SPENDING Bush gave ground. Initially, he proposed a K-12 budget hike of 5%, or \$1.8 billion, for 2002. He then agreed to up spending by an additional \$4 billion. Democrats wanted \$9 billion more. Congress also will give states more spending flexibility, though not as much as Bush wanted.

PASS, FAIL, COMPROMISE

As Congress wrangles over the President's ambitious education agenda, a deal is coming together



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Social Issues

publicans fiercely oppose more budget spending hikes for schools. "There needs to be some restraint," says Senate Majority Leader Trent Lott (R-Miss.).

But aren't new tests expensive?

Members of both parties—especially governors and state officials—say Bush's plan doesn't provide enough money for testing. They cite a study by the National Association of State Boards of Education that says states would have to spend up to \$7 billion total to develop the tests. Bush set aside just \$320 million to help states do this. "I'm all in favor of a moderate federal role [in education], but I don't want that to mature into a full-fledged unfunded mandate," says Senator Ben Nelson (D-Neb.). But in the end, it looks like states won't get much more money for testing.

Aren't there other objections to tests?

Yes. Democrats argue that they take up too much class time and don't provide much useful information about student performance. Others claim that such tests discriminate against ethnic minorities and the poor. Teachers particularly dislike the idea that low-performing schools could lose millions of dollars in federal funds under Bush's plan. They worry that this could cost them jobs.

Didn't Bush want to give all states the freedom to spend federal dollars as they see fit?

Yes. Senate and White House negotiators have agreed to a pilot plan that would allow 15 states to spend their federal dollars with no strings attached instead of targeting specific programs. This is a compromise for Bush.

What happened to vouchers?

Bush made a big deal about using public money for private schools in his campaign. But it's just too controversial, even in the GOP. So he dropped it.

But Bush will still end up with much of what he wants?

Yes. Most observers expect Congress to deliver an education reform bill the President will be willing to sign. Some of the consequences may be more than the GOP is bargaining for. For example, Washington would get more say in how public schools are run, and the Education Dept. could end up policing pupil progress. Nonetheless, it seems likely that Bush will be entitled to call himself the Education President.

By Lorraine Woellert in Washington

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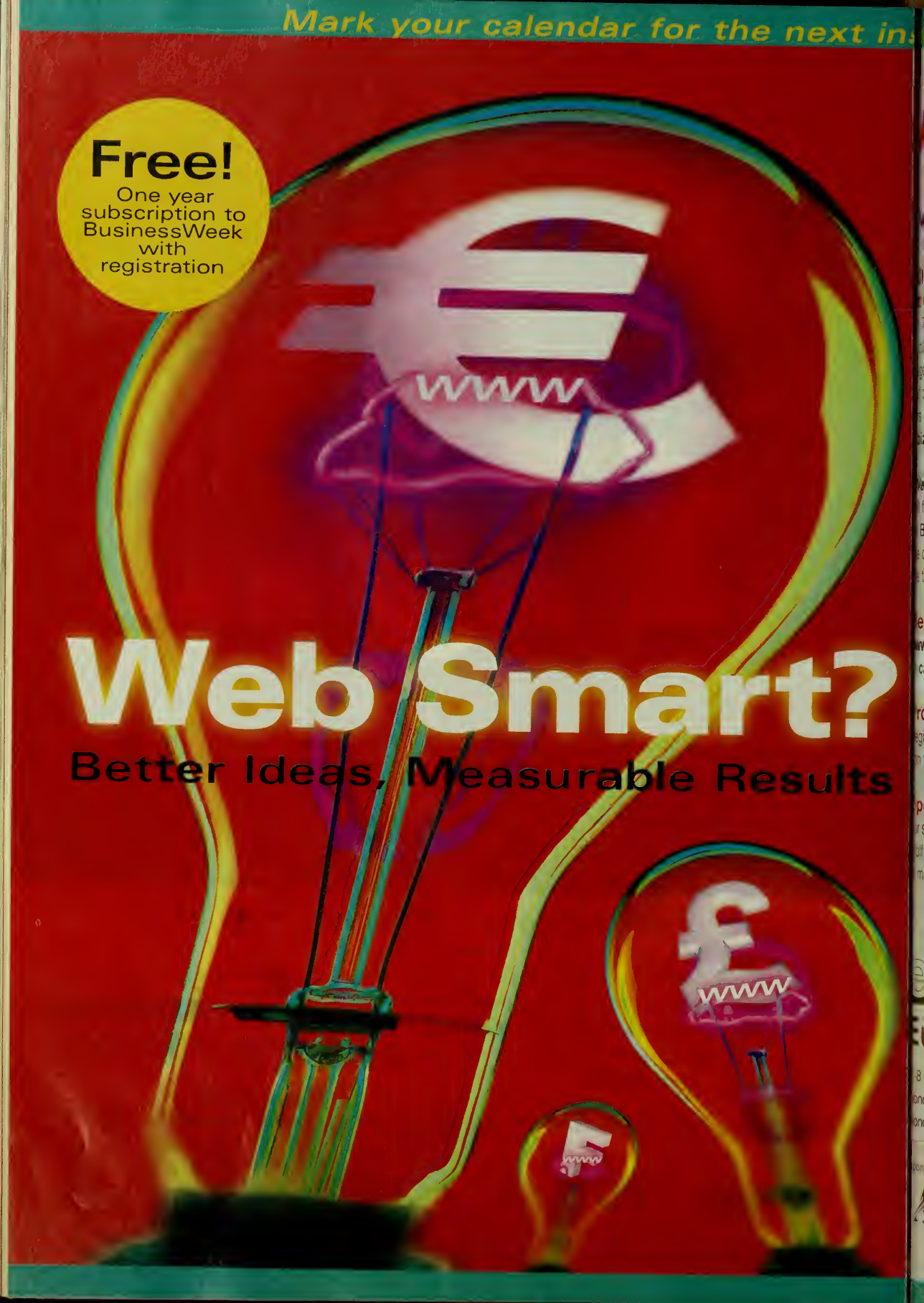
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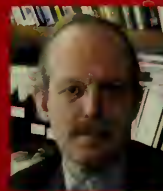
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MOVIES

THIS PEARL HARBOR LOOKS LIKE A VICTORY

Jerry Bruckheimer's war flick is generating a powerful buzz

Jerry Bruckheimer, looking every inch the Hollywood producer in his trademark head-to-toe black outfit and close-cropped beard, breezes into the ultra-sleek Santa Monica (Calif.) offices of Michael Bay, the director of Bruckheimer's film, *Pearl Harbor*. Striding briskly down a hallway, he's quickly joined by assistants, each with a problem in search of a solution. A ticket for Romania has been booked so Bruckheimer can check in on the filming of *Black Hawk Down*, a military action film Ridley Scott is directing. From a nearby office, Bay jumps out with good news. Hans Zimmer, the Oscar-winning composer, has had a breakthrough on writing the musical score for *Pearl Harbor*, set to open May 25. "We're good," says Bay, flashing the thumbs-up sign. In fact, things are

very good for Bruckheimer, Hollywood's current top gun. Two of his last three films, *Remember the Titans* and *Gone in 60 Seconds*, grossed more than \$100 million at the box of-

SLAM-BANG: Bruckheimer had to cut costs to meet his \$135 million budget

fice, marking the fifth and sixth times Bruckheimer film has crossed the threshold since 1996. His TV show *Crime Scene Investigation* is a surprise hit on CBS. And the buzz on *Pearl Harbor* is intense, with insiders predicting the wartime epic's box office could easily hit \$200 million.

That makes *Pearl Harbor* the film to beat in a summer already stocked with such big-budget films as Steven Spielberg's *A.I.: Artificial Intelligence* and director Tim Burton's remake of the 1968 film *Planet of the Apes*. For a Hollywood

that won't feel the pinch of a likely strike by its writers and actors until next year, *Pearl Harbor* could further boost a box office that's already 14% above last year. It even has other studios steering clear to avoid the movie's launch on Memorial Day weekend. No major rival is expected until mid-June with the heavily hyped *Tomb Raider*.

Bruckheimer's struggle with the Walt Disney Co. over *Pearl Harbor* is already the stuff of Hollywood legend. A man known for his free-spending ways as Disney is famous for its fiscal tightness, Bruckheimer, along with Bay, fought Disney's Touchstone studio for months

ONE HOT SUMMER IN HOLLYWOOD

This year, the studios boast an unusually strong lineup:

FILM	STUDIO	RELEASE DATE	BUDGET (MIL.)	BUZZ
PEARL HARBOR	Disney	May 25	\$135	Film to beat this summer
SHREK	DreamWorks	May 18	\$40	Ogre spoofs Disney all the way to the bank
TOMB RAIDER	Paramount	June 15	\$80	Fem action hero Angelina Jolie kicks butt
A.I.: ARTIFICIAL INTELLIGENCE	Warner Bros.	June 29	\$95	Hot formula: Spielberg and sci-fi, together again
JURASSIC PARK III	Universal	July 18	\$93	Spielberg is gone, but the dinos are scarier
PLANET OF THE APES	Fox	July 27	\$100	Tim Burton remake. Lots of box office potential

Data: Exhibitor Relations Inc., BusinessWeek

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over *Pearl Harbor's* budget. The studio forced Bruckheimer to slash his initial special-effects laden budget by 25%, to \$135 million. To get there, Bruckheimer and Bay persuaded hot-shot actors Ben Affleck and Cuba Gooding Jr. to slash their \$10 million fees and work for \$250,000 and a piece of any profits later. Some scenes were filmed at the Mexico water tank used for *Titanic*, saving on expensive ocean shots. Bruckheimer and Bay each gave up \$5 million salaries in return for a cut of profits and agreed to cover any cost overruns.

CRACKDOWN. Sure enough, *Pearl Harbor* has all the elements of a Bruckheimer movie—hot stars, slam-bang action, and lots of explosions. But after spending nearly \$190 million to make *Armageddon* and seeing its margins squeezed, Disney has been cracking down on Bruckheimer's freedom. Last year, it decided to make the Denzel Washington football film, *Remember the Titans*, only if Bruckheimer would scale back costs and reduce the violence. And it pulled the plug altogether on *Black Hawk Down*, says Disney studio chief Peter Schneider, because

WILD RIDES

Bruckheimer's taste for high-octane action pictures has resulted in two huge hits and costly overruns



of fears the film would cost as much as \$115 million. Joe Roth, former Disney studio chief, picked up the helicopter movie for his new Revolution Studios. The budget now? \$85 million.

It isn't often that one of Hollywood's superstar producers gets one of his films bounced. But Bruckheimer's career has been marked with both huge hits and costly overruns. His 14-year partnership with fast-living Don Simpson, which created such megahits as *Beverly Hills Cop* and *Top Gun*, reached its roughest patch with the 1990 car-racing movie *Days of Thunder*. The film, starring Tom Cruise, blasted past its \$60 million budget and put the two on the outs

with Paramount Pictures. The next year, the duo, with the matching black Ferraris, moved to Disney but made few films there before Simpson died of a drug overdose in 1996.

Since Simpson's death, Bruckheimer has expanded his repertoire by making smaller films well. Disney made a tidy profit on his movie *Coyote Ugly*; the movie about barnmaids made \$45 million. Bruckheimer is now in production on four films,

including a modest-budget buddy comedy starring Chris Rock and Anthony Hopkins as FBI agents.

But the hit-in-waiting is *Pearl Harbor*. The movie came in a scant \$210 million over budget, says Bay. And after the money hassles, Bruckheimer says he won the biggest battle of all by keeping in the final scene, in which American fighter Jimmy Doolittle retaliates by bombing Tokyo. "This film couldn't end with a downer, like *Titanic* did," says Bruckheimer. "America had to win the one. People needed to walk out happy. Spoken like a true producer."

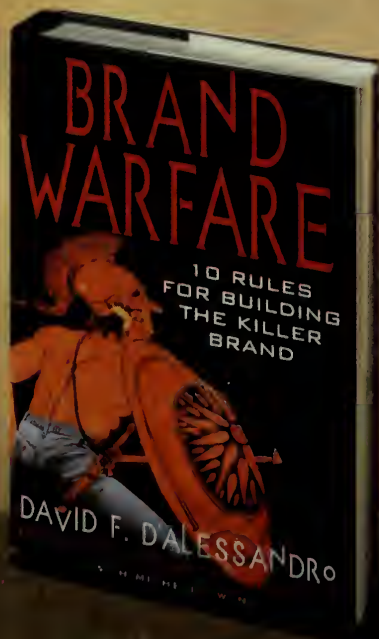
By Ronald Givens
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generation **d**



Patti Hart, Chairman and CEO

“The cash position of the company is paramount. I need to investigate all of the alternatives”

INTERNET

IF ANYONE CAN SAVE EXCITE...

The company has high hopes for ex-Telocity CEO Patti Hart

The end may be near for the once-mighty Excite Internet portal. Patti S. Hart, appointed chairman and CEO of Excite@Home Corp. on Apr. 23, already is exploring opportunities to sell the money-losing Excite business and may shut it down in the next several months if no buyers

emerge, *BusinessWeek* has learned. It would be an inglorious end to a portal that once rivaled Yahoo! and was one of the pioneers of the Internet. “The cash position of the company is paramount,” says Hart. “I need to investigate all of the alternatives.”

That’s just the kind of hard-nosed

leadership that Excite@Home needs these days. The Redwood City (Calif.) company, which operates the Excite search engine and provides broadband Net connections over cable TV networks, is in desperate straits. Last year, it had revenues of \$616 million and lost \$1.1 billion, including a huge writedown of assets that had acquired that are now useless. It’s burning cash so fast that the company says it may not survive if it can’t raise \$75 million to \$85 million by the end of June. Its stock has dropped from \$12 two years ago to about \$4 now.

BACKBONE. So who is the woman willing to take on this troubled company? The tale of how Hart came to Excite@Home’s new chief suggests that the 44-year-old telecom veteran has the backbone and decisiveness necessary to give the company a fighting chance. During her negotiations with Excite@Home’s board, Hart insisted on the freedom to sell off assets, including Excite, according to one source close to Hart. She also helped convince the company’s board to ask former chairman and CEO George Bell to resign, even though he had planned to stay on as chairman until the end of 2001. “I think Patti didn’t want any confusion about who was in charge of the company,” says analyst Abhishek Gami of William Blair & Co.

She made sure she would be well compensated, even if Excite@Home doesn’t survive. She will receive a base salary of \$550,000 and a bonus of as much as \$412,500 yearly, according to documents filed with the Securities Exchange Commission. And she will be paid a signing bonus of \$1 million spread over 18 months. If Excite@Home is acquired or goes under, she will receive

AS TOUGH AS NAILS

How Hart became the chairman and CEO at

Excite@Home

DEC. 21, 2000 Telicity CEO Patti Hart announces deal to sell the broadband Net provider to

Hughes Electronics, parent of DirecTV.
EARLY 2001 Headhunter Jeffrey Christian contacts

Hart about taking the Excite CEO post, then held by George Bell, who is also chairman.

APR. 3, 2001 Hughes completes its acquisition of Telicity for \$178 million. The price is \$2.15

a share, 82% less than the price at which Telicity went public the year before.

APR. 13 Hart is ready to join Excite as CEO, while Bell remains chairman.

APR. 14 Execs inform Hart that Excite will pre-announce poor financial results, and it will need >>>

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Information Technology

ceive one year's salary as well as 100% of her targeted bonus. Under certain circumstances, she could get two years' salary and all of her possible bonus.

The job of luring Hart to Excite@Home began earlier this year when she was contacted by Jeffrey E. Christian, a headhunter at Christian & Timbers in Cleveland. "She is an incredible find," says Christian. "She is almost a perfect fit." Over 14 years, Hart had made a name for herself at Sprint Corp., rising to head the core long-distance business. In June, 1999, she left to run upstart Telocity Inc., which provides broadband connections over telephone lines.

But by December, 2000, Telocity's fortunes had begun to founder, and Hart cut a deal to sell the company to Hughes Electronics Corp., which provides broadband Net connections through its DirecTV subsidiary. Was Hart interested in the Excite@Home job, Christian wondered? Although she was hesitant because the Telocity sale hadn't closed, she was "willing to listen," he says.

CAUTIOUS. The more she listened, the more attractive the job sounded. "People who know me say this is such an obvious fit for you," says Hart, who had the broadband experience crucial for Excite@Home. Still, she was cautious. Her experience at Telocity had been rough. The company started running short of cash only months after its initial public offering in March, 2000. When Hart ultimately agreed to sell Telocity to Hughes, it was for \$2.15 a share, 82% less than the price at which the company had gone public. "She did as well for her investors as anybody could have," says Leo Hindery Jr., a cable exec who sat on Telocity's board.

Hart combed Excite's SEC filings. Sure, the company was losing money, but it looked as if it had enough cash to last a good while. Plus, she took comfort in the backing of AT&T, Excite's controlling shareholder. By Apr. 13, a Friday, she was sold enough that Excite started

setting up press interviews for her the next week.

Then trouble hit. On Saturday, Apr. 14, Bell and Excite's Chief Financial Officer Mark McEachen told Hart that the company's finances were deteriorating. In fact, the company was facing a se-



George Bell, former CEO

“I think their fear was that Patti may not feel she had total control”

vere cash crunch and needed to raise at least \$75 million by the end of June. It only had \$105 million in cash at the close of the first quarter, about half the \$201 million it had three months earlier. Hart declined to comment on what happened that weekend, but the source close to Hart was blunt. "She went nuts," he says. "Patti can't afford to be on the wrong side of another one."

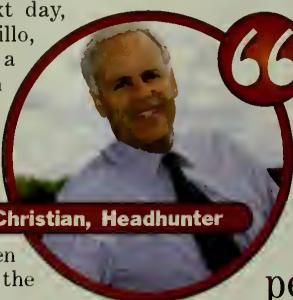
After she learned about Excite's dire financial straits, Hart toughened up her negotiating with the board. Hart confirms she talked the next day, Sunday, with John Petrillo, AT&T's chief strategist and a member of Excite's search committee, although she declines to provide details. It was over the next few days that Hart insisted on the ability to sell or shut Excite and that she be given the chairmanship, says the Hart source.

Hart's portrayal is slightly different. She says she had detailed conversations with Excite's board about how much freedom she would have to sell off certain assets. But, she says, she never insisted that Bell resign. Rather, she says, "George stepped up and said it was time to make a change." Not so, says

Bell. He says he received a call from Excite board member he won't name, suggesting that he give up the chairman's post. "I think their fear was that Patti may not feel she had total control," he says. A second source, close to the board, says directors already lost confidence in Bell because of the company's performance. Bell negotiated a severance package that will pay him his \$400,000 salary through June and 50% of his 2001 bonus. Hart was named CEO and chairman on Apr. 23.

While Hart got what she wanted in her negotiations, she's hardly home free. Excite@Home has a tentative deal to sell parts of its network to AT&T to raise the cash it needs, but that would only solve the company's cash woes for this year. And selling the Excite business won't be easy, because few companies are interested in Net portals these days.

At least, Excite@Home isn't going to end up in bankruptcy like so many other dot-coms. AT&T and the other cable operators use the company to install broadband connections. The @Home piece of the business has become the largest provider of broadband Net connections in the U.S. with 3.2 million subscribers. Excite@Home runs out of cash, its operations may be folded into AT&T or divi-



Jeffrey Christian, Headhunter

“She is an incredible find. She is almost a perfect fit”

up among several cable companies. Hart is determined not to let that happen. "We're leaders in an industry that everybody believes in," she says. Hart will need the backbone she showed during her negotiations to keep this beleaguered Net upstart afloat.

By Peter Elstrom in New York

Excite @ Home

up to \$85 million this year to survive.

APR. 15 Worried that she may be walking into a hopeless situation, Hart

talks with Excite's board and insists on two things, according to a source: that she have the authority to

sell or close the Excite portal, and that she get the chairman post as well as the CEO job. Hart says she never

insisted that Bell resign.

APRIL 16-20 George Bell receives a call from an Excite board member who raises the

possibility that he should give up the chairmanship, according to Bell. After a severance package is negotiated,

Bell agrees to step down.

APR. 23 Hart is officially announced as Excite's CEO and chairman.

APR. 30 Hart slashes 380 jobs—16% of its workforce—and begins exploring an Excite sale.

A man wearing a dark cap and a brown leather jacket over a dark shirt and blue jeans stands in a field. He is looking towards the camera with a slight smile. The background is a soft-focus field of crops.

Biotechnology
is helping him
protect the land
and preserve his
family's heritage.

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—Rod Gangwish, farmer

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Companies use every trick to pump earnings and fool investors. The latest abuse: "Pro forma" reporting

THE NUMBERS GAME

Cover Story

BY DAVID HENRY

It is simply a matter of creative accounting," says Matthew Broderick, playing bean counter Leopold Bloom in the hit musical *The Producers*. "Under the right circumstances, a producer could make more money with a flop than he could with a hit." Michael Bialystock, Bloom's client, immediately sees the potential for solving his money woes. He raises as much as he can from rich widows to finance a new Broadway musical, *Springtime for Hitler*. He blows the money on himself,

tending for the show to bomb so that nobody will ask awkward questions.

For all the hoopla on the Great White Way, Bloom is primitive in the numbers game. He's operating without pro forma accounting, which allows all kinds of fictions in the way companies present their earnings. In the great bull market of the 1990s, companies and their CEOs used aggressive tricks to deliver the continually rising sales and earnings that Wall Street wanted to see. It's gotten far worse in the market slump. The pricking of the Wall Street bubble has stepped up the pressure on desperate CEOs to shore up earnings ravaged by the sudden economic slowdown. Whether it's boom time or bust, companies have cast aside constraints on how they report sales and earnings to the public. They are dodging accounting rules built up over decades, choosing instead a slew of unconventional and often questionable practices that would turn Bloom green with envy.

Sure, companies have always tried to present themselves in the best possible light. But some of today's practices, though perfectly legal, sail close to the wind: They seem designed to mislead unwary investors about the real financial state of companies that use them. Fading dot-coms, new tech giants, and venerable blue chips all hype their earnings. Cisco Systems Inc. subtracts payroll taxes on employee stock options in its earnings-per-share numbers. IBM lifts its earnings by assuming it would pay less into its pension fund, and Motorola Inc. boosts sales by lending huge sums to customers. "CEOs were obsessed with growth," says Christopher M. Davis, a portfolio manager at the family firm of Davis Selected Advisers. "They, as in the past, tortured accounting to produce income statements that would be applauded by Wall Street."

The full extent of bad stuff that happened during the boom is only now becoming clear—and it is worse than any



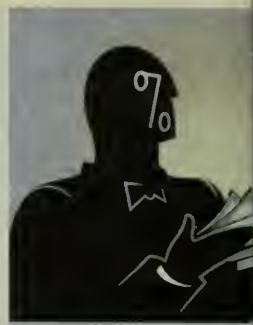
one thought. Ordinary investors and Wall Street pros alike are beginning to cry foul.

What's alarming them is that the games affect the stock market and its integrity every day. It's getting harder to answer the basic questions that underlie rational investment decisions. What is a company's bottom line? Is it making money or not? What is the price-earnings ratio on its stock? The answers are all over the place.

Variations in how companies report their results make it harder to know if their valuation is cheap or rich compared with their peers and the rest of the market. Chip-maker Intel Corp. includes gains from stock investments in its preferred earnings measure; Cisco does not. And with

TRICKS OF THE TRADE

How companies pump up sales and earnings



PLOY

BIG BATH

VENDOR FINANCING

HOW IT WORKS

Takes a large write-off, booking costs now to boost earnings and margins in the future.

Lends money to financial fragile customers so that they can buy products, pumping sales and profits.

DRAWBACK

Unless operations improve, more charges must be taken to maintain earnings. Eventually, investors shun the stock.

Company can be left with bad debts—and falling sales, when it stops lending.

Cover Story

inconsistent numbers seeping into calculations of p-e's for the major indexes, it's harder to gauge whether the market is valued high or low compared with the past. Companies "are destroying the credibility of the profits they are producing," says Robert Olstein, manager of Olstein Financial Alert, a mutual fund. "There is no way some of these companies were growing at the rates they were representing."

CREDIBILITY GAAP. The emergence of pro forma accounting is what enables companies to play the numbers game to the hilt. Tech companies in particular discovered a powerful new way to obscure what was really happening in their often shaky businesses. Traditionally, pro forma accounts were a way of giving an idea of what earnings would look like in completely new businesses or in those that would result from a merger. But real New Economy companies now conjure up a second set of figures—created outside generally accepted accounting principles, or GAAP, which still must be used in reports to the Securities & Exchange Commission—and call them pro forma. "It is open season [for companies] to say what they want in press releases," says Chuck Hill, research director at Thomson Financial/First Call, an earnings tracking service.

GAAP is a set of accounting rules hammered out by regulators, companies, and their auditors over decades. It aims to give a fair and true picture of a company's financial position and make it harder for executives to hype their results. GAAP rules are applied to every company, no matter what its business or stage of development. A small biotech startup with little more than patentable ideas is treated the same way as a fast-food empire or a giant auto maker with billions invested in plants. Some companies argue that GAAP isn't always the best way of measuring how they're doing. And on some points, even skeptical investors agree with them. But the virtue of GAAP is that it is the most consistent and objective

WHO'S DONE IT

Cisco, DaimlerChrysler, Kodak

Motorola, Lucent, Nortel

way to compare results across companies and industries.

That can't be said of pro forma. Each company uses it a way it wishes. Yahoo! Inc., one of the first to emphasize pro forma, in January, 1999, presented results 35% better than GAAP by excluding a variety of costs of buying Internet companies. In its latest set of results, issued on Apr. 11, Yahoo! included yet more items, such as payroll taxes on stock options. Data center operator Exodus Communications Inc., in its version of pro forma, also excludes some acquisition costs, but apparently not options taxes. Network Associates Inc. (table on page 106), meanwhile, conveniently drops a loss-making 80%

“They, as in the past, have tortured income statements that would be applauded

owned subsidiary, McAfee.com Corp., in working out its pro forma results, which show only half the loss reached under GAAP. In a Mar. 27 press release, software company Xcare Inc. reported revenues before subtracting the cost of warrants to buy Xcare shares that it gave to a customer. The value of the warrants was given lower down in the release, but the headline numbers boosted the company's apparent sales by 69% and cut its losses by 40%. Xcare Chief Financial Officer Gary T. Scherping says he wasn't trying to fool anybody. "I could probably have come up with another three things that could have excluded had I wanted to play those games... that other people regularly do," he says.

Amazon.com Inc. can't even settle on a single definition of pro forma. In its Apr. 24 results announcement, it reported "pro forma operating" loss of \$49 million in the first quarter of this year. Confusingly, it also reported a "pro forma net" loss of 21¢ a share, equivalent to \$76 million. Investors had to pick



Jan. 24 release. Shareholders had to wait weeks to find out, in a footnote to the annual results, that Qwest actually lost \$116 million, according to GAAP rules. Qwest says the variation is extreme because of adjustments for its takeover of US West Inc.

Some companies with profits can really give themselves a lift. Take Quintiles Transnational Corp., a number cruncher that sells statistical services to the drug industry. In press releases, it excludes the costs of Internet operations when it reports earnings from "core operations." The result: a 77% higher net income. Quintiles' investor relations officer, Greg Connors, says there's nothing wrong since GAAP results are attached: "We thought this was the best way to describe

ourselves to the market." Including the cost would make it hard for investors to compare Quintiles with rivals that don't invest so much in the Net, he says, calling the cost "unusual." But the expenses aren't a one-time event: They have been going on for a year, and they are continuing.

The spread of pro forma earnings has plunged investors into an Alice-in-Wonderland world. SEC Chief Accountant Lynn E. Turner calls pro forma results "EBS earnings"—for Everything but Bad Stuff. "Way too often, they seem to be used to distract investors from the actual results," Turner says. Wall Street, of course, is happy to play along: First Call's Hill says more than 260 companies have persuaded a majority of top financial analysts to abandon GAAP when making earnings estimates.

Pro forma is the most egregious of the numbers games. But new variants of old accounting tricks are also flourishing throughout the corporate world. Here are the gambits for which investors should be on the lookout:

■ VENDOR FINANCING.

Pressure from Wall Street for ever increasing sales generated lots of bad numbers as high-tech companies took to overstating their revenues by lending big to customers. In moderation, vendor financing is a sound selling technique; abused, it's a dangerous way to do business. Just ask some telecom-equipment suppliers: By the end of 2000, they were collectively owed as much as \$15 billion by customers, a 25% increase in a single

ION GAMBIT

A pension plan is added and cuts company expenses. Hides gain in annual footnotes.

BEFORE ITS TIME

Treats pending sales as if they have already occurred, books sales without subtracting promised rebates.

BACKDOOR BARGAINS

Promotes sales by buying a big customer's stock or granting it cheap warrants.

of return on pension payments may worsen, big bigger future expenses.

Cuts future sales and earnings, giving appearance of faltering company performance unless operation is repeated.

Investors may be suspicious of stated values; hard to do over again, so future results could falter.

E MicroStrategy, Informix, Cendant

Flextronics, Amazon

efully among a slew of numbers to see that Amazon actually had a net loss of \$234 million, or 66¢ a share, using GAAP. Among the items excluded from pro forma operating losses are a net interest expense of \$24 million and a \$114 million charge for restructuring costs, such as closing a warehouse. The pro forma numbers are how we think about "business" and how Wall Street analysts follow. Says Amazon spokesman Bill Curry, emphasizing that the GAAP numbers are included. The magic of pro forma can turn losses into profits. That's just what happened at Computer

Accounting to produce Wall Street "E"

— CHRISTOPHER M. DAVIS,
Davis Selected Advisers

sociates International Inc., whose accounting was challenged in an Apr. 29 story in *The New York Times*. By changing the terms of its software sales and how it accounts for them, it reported 42¢ of pro forma earnings per share in the final quarter of last year, vs. a 59¢ loss under GAAP. Company officials say the new presentation is actually more conservative and not meant to enhance growth. Similarly, giant telecom carrier Qwest Communications International Inc. reported \$2 billion in quarterly earnings before interest, taxes, depreciation, and amortization, or EBITDA, an early version of pro forma, in a



“Way too often, [pro forma results] seem to be used to distract investors from the actual results”

— LYNN E. TURNER,
Securities & Exchange Commission

year. Effectively, they were buying their own products with their own money, exaggerating the size and sustainability of their sales and earnings growth. “It is only now, in hindsight, that it is turning out that it wasn’t real revenue growth at all, just bad receivables,” says Hank Herrmann, chief investment officer at Waddell & Reed Financial Inc., a fund manager.

Investors were spooked to discover, deep in a company filing to the SEC on Mar. 30, that Motorola is owed \$1.7 billion by Turkey’s No. 2 wireless carrier, Telsim. In a Feb. 3, 2000, press release announcing a \$1.5 billion order from Telsim, Motorola made no mention of any loans. “That is a risk I would have liked to have known about years ago,” complains portfolio manager Davis.

The risk is not just that the customer won’t pay, but that

Cover Story

the customer won’t buy more products unless Motorola lends it more. Since the original announcement of the Telsim order, Motorola stock has fallen 69%, losing about \$75 billion of its market value. Motorola says it properly disclosed its financing practices in filings to the SEC. The loan is backed by a claim on “significantly” more than half of Telsim’s stock, says spokesman Scott Wyman.

Employee stock options have proved useful throughout the economy in recruiting and holding staff. But companies don’t have to deduct the cost of options from their income, as they must for wages paid in cash. So they have a powerful tool to pump up profits in the short run—at the cost of diluting ordinary shareholders’ equity as employees exercise their options. A handful of companies, such as Boeing Co. and Winn-Dixie Stores Inc., decline to play that game, and charge the estimated value of options immediately. But most don’t expense the costs—some to terrific effect. At coffee chain Starbucks Corp., for example, expensing the value of options would have reduced reported net income by \$28 million, or 30%, in the year through October. At Cisco, it would have reduced reported income by \$1.1 billion, or 42%, in the year through July. Furthermore, the compounded annual growth of Cisco’s reported net income for the three previous years would have sunk to 33% from 41%, according to Bear, Stearns & Co. accounting analyst Pat McConnell. Veteran short-sell-



er James Chanos of Kynikos Associates Ltd. calls the treatment of options “a national outrage... an ongoing shame.”

Aggressive options accounting makes overall corporate profits look much higher than they really are. McConnell Bear Stearns figures the average earnings growth rate of companies in the Standard & Poor’s 500-stock index with options fully expensed would have been cut from 11% to 4% for the three years to mid-2000. But the information is hard to come by. Companies are required only to disclose their option costs in a footnote to their annual reports.

■ **SQUEEZE AND STRETCH.** Companies that need to show earnings growth can help themselves by booking sales early or costs late. For instance, software company MicroStrategy Inc. reported revenue in three quarters in 1998 and 1999 based on contracts it did not complete until after the quarter had ended, the SEC found. The company restated three years’ worth of profits to losses and settled the matter with the SEC, neither admitting nor denying the allegations. Three corporate officers agreed to pay penalties totaling \$1 million.

More companies than ever are boosting earnings by changing assumptions that will lower their reported expenses, says the SEC’s Turner. Typically, executives use stratagems such as extending the expected life of assets to reduce depreciation charges or betting that they’ll have fewer bad debts. Reader’s Digest Association Inc. became more optimistic about the number of customers who would pay their bills on time after it gained about 16¢ a share in last year’s December quarter, says fund manager Olstein. Reader’s Digest spokesman William Adler says the company’s collection estimate “is not put in

RED FLAGS

Companies may
be up to hanky-
panky when...

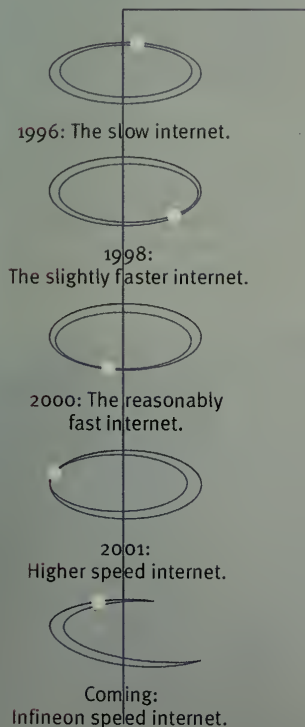
- ✓ Profits grow faster than cash flow
- ✓ Sales slow while inventories pile up faster
- ✓ Reserves against bad debts are cut sharply
- ✓ Ways of calculating revenue and expenses change
- ✓ Unpaid customer bills outpace sales
- ✓ Sales are booked before payments are received
- ✓ Gross margins increase or decrease dramatically
- ✓ Auditors, lawyers, or key execs change



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SPINNING EARNINGS

The pro forma per share earnings look a lot better than GAAP in the latest quarter

COMPANY	PRO FORMA	GAAP	CHANGE
JDS UNIPHASE	\$0.14	-\$1.13	\$1.27
CHECKFREE	-0.04	-1.17	1.13
TERAYON	-0.43	-1.01	0.58
AMAZON.COM	-0.22	-0.66	0.44
PMC-SIERRA	0.02	-0.38	0.40
CORNING	0.29	0.14	0.15
QUALCOMM	0.29	0.18	0.11
CISCO SYSTEMS	0.18	0.12	0.06
EBAY	0.11	0.08	0.03
YAHOO!	0.01	-0.02	0.03

Data: Company announcements

affect income in any way." He says the estimate was raised properly, because its mix of business had shifted from books toward subscriptions, which are more likely to be paid.

In some cases, there has been no change in assumptions at all, but a questionable judgment from the start. The SEC recently took issue with Verizon Wireless Inc.'s decision to amortize the cost of its wireless licenses over 40 years instead of 20 years or less. The longer amortization, which Verizon

says is appropriate because the licenses are renewable, helps earnings, but assumes the

licenses will never lose value because of another technology.

Company pension plans can become a fruitful source of extra earnings. Companies can't generally take money out of their pension funds, but by juggling several factors, including the actuarial present value of benefits, interest rates, and expected returns on assets, they can reduce or even eliminate what they have to pay into their plans in any given year, according to Gabrielle Napolitano, accounting maven at Goldman, Sachs & Co. For example, IBM picked up \$195 million—1.7% of pretax income—in 2000, when it raised the expected rate of investment return from 9.5% to 10%.

Companies, of course, would rather have investors imagine that all their earnings are coming from their businesses. So some try to disguise the pension lift by lumping it with oth-

er retirement benefits costs, says Jack T. Ciesielski, publisher of the *Analyst's Accounting Observer* newsletter. General Electric Co.'s annual report says 6.5% of its \$12.7 billion earnings in 2000 were from "post-employment benefit plan" which cover everything from pensions to retiree health plans. Take out the cost of retiree health- and life-insurance benefits which are found in footnotes, and the boost from the pension plan leaps to 9%. With the stock market in a funk, companies may not be able to count on the same gains in the future. Indeed, they may have to cough up to keep their plans whole.

■ **BIG BATH.** The slowing economy is giving a maneuver known as the big bath a whole new lease on life. A company takes a huge restructuring charge one year, often when making losses or much lower profits than before. It may sound crazy to make losses look worse, but the ploy gives a company big help in reducing expenses and enhancing earnings in the future. On Apr. 16, Cisco announced two write-offs. One charge, of up to \$1.2 billion, is for the cost of laying off workers, closing buildings, and erasing goodwill from the balance sheet. The other is to write off \$2.5 billion of excess inventory, primarily raw materials that Cisco says have zero value. Will Cisco sell the inventory, or use it in production later? A Cisco spokesman said the inventory is worthless and "we have no plans to use it, period."

Worried about the possible abuse of the big bath technique, the SEC in late 1999 directed companies to disclose sizable charges in more detail. But the facts are still sometimes hard to find. Even before Computer Associates' issues were revenue recognition surfaced, analysts were suspicious of earnings numbers. Last year, Sterling Software Inc. apparently took a charge right before being acquired by CA, a move that may have accelerated operating expenses to the benefit of CA's later earnings, according to Howard Schilit, head of the Center for Financial Research & Analysis, an earnings watch service. CA says the charges were described in its filings to the SEC and notes that it reported lower-than-projected earnings following the merger.

How did earnings reports slide into such chaos? It's tempting to finger the auditors, who after all are supposed to be the first line of defense against financial chicanery. But that would be too simple. "Auditors are really not responsible for doing analysis on financial reports," says Schilit. A more serious problem is that strict accounting is losing its champions within companies. Fewer and fewer chief financial officers are certified public accountants, notes the SEC's Turner.

"Everybody is to blame here," says a veteran hedge-fund manager, who admits that he, too, was buying rising stock

Cover Story

HOW NETWORK ASSOCIATES HALVED ITS LOSS

By making adjustments to the GAAP net, the company sliced first-quarter, 2001, losses in two

	CONSOLIDATED GAAP RESULTS	PRO FORMA RESULTS*
MILLIONS		
GROSS PROFIT	\$136.4	\$127.0
LESS R&D, sales, marketing, administrative expenses	-178.8	-168.1
LESS Amortization of intangibles and stock charge	-17.5	0
OPERATING LOSS	59.9	41.1
PLUS Net interest income, minority stakes, tax benefits	+12.5	+16.7**
NET LOSS	47.4	24.3
PER SHARE LOSS	35¢	17¢

*Excludes results of 80%-owned McAfee.com

**Omits interest paid on convertible debt

Data: Apr. 19 company earnings announcement



Fannie Mae helps save home buyers
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over the life of their loans.



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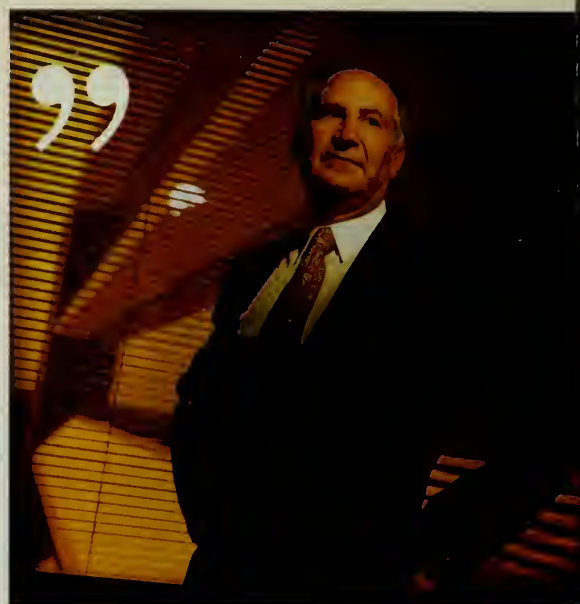
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“Auditors are really not responsible for doing analysis on financial reports”

— HOWARD SCHILIT,
Center for Financial Research & Analysis

with little regard to how companies were spinning their numbers. Mutual-fund portfolio managers learned in the bull market that if they took time to check details in financial reports before buying a stock, competitors would have already bid up prices. Analysts at Wall Street investment banks started spending more time soliciting underwriting business and less time verifying what managements were telling them, complains Philip T. Orlando, chief investment officer at Value Line Asset Management Services, a money manager.

AOL'S PAYOFF. Today's abundance of ways of calculating earnings has its roots in the 1980s heyday of the junk-bond market and, ironically, in deliberations by the Financial Accounting Standards Board, the major accounting rulemaker. Purveyors of junk made EBITDA part of Wall Street's daily



Cover Story

buyout. LBO firms then used it to promote sales of stock back to the public in the mid-1990s. FASB responded to the interest by considering a rule under which companies would also report something to be called “cash earnings” that would have been similar to EBITDA. FASB ultimately dropped the idea but by then had opened a Pandora's box, encouraging companies to ignore GAAP as the prime measure of earnings.

But now, with the renewed skepticism that comes amid big stock market losses, investors and regulators are much less inclined to tolerate aggressive accounting. “We're going to force better disclosure,” promises money manager Herrmann.

Trouble is, it takes the regulators ages to clamp down on questionable practices, allowing companies to hoodwink investors in the meantime. For years, America Online Inc. ag-

vocably deferred the marketing expenses of sending millions of computer disks to potential customers. That enabled AOL to look more profitable than it really was, helping it issue securities for cash and acquisitions that fed growth. By the time AOL submitted to an SEC settlement May 15, 2000 (without admitting or denying any wrongdoing), paid a \$3.5 million fine, and restated its former income to losses, the company was home free. It was an Internet giant. Now, AOL owns communications giant Time Warner and is called AOL Time Warner Inc. “If AOL were by itself today, its stock price would be a lot lower... [so] the accounting aggressiveness paid off,” says David W. Tice, money manager who publishes the earnings watch bulletin *Behind the Numbers*.

Under former Chairman Arthur Levitt, the SEC started a campaign against numbers games in September, 1998 (table). Among the results: a financial fraud task force, which SEC enforcement chief Richard Walker says has been “working

aggressively deferred the marketing expenses of sending millions of computer disks to potential customers. That enabled AOL to look more profitable than it really was, helping it issue securities for cash and acquisitions that fed growth. By the time AOL submitted to an SEC settlement May 15, 2000 (without admitting or denying any wrongdoing), paid a \$3.5 million fine, and restated its former income to losses, the company was home free. It was an Internet giant. Now, AOL owns communications giant Time Warner and is called AOL Time Warner Inc. “If AOL were by itself today, its stock price would be a lot lower... [so] the accounting aggressiveness paid off,” says David W. Tice, money manager who publishes the earnings watch bulletin *Behind the Numbers*.

A REPORT CARD ON THE REGULATORS

How the SEC is doing on implementing plans to reduce accounting hocus-pocus

PLAN	RESULT	GRADE
ACCOUNTING ASSUMPTIONS Any changes must be disclosed in detail.	Rule proposed in Jan. 2000; still pending	D
RULES Accounting bodies to clarify R&D rules and issue new ones for restructurings, write-offs in large acquisitions, and revenue recognition.	AICPA will issue R&D and write-offs guide by yearend; FASB rules for restructuring by third quarter. No timetable for FASB action on complete revenue-recognition rules.	C
REVENUE RECOGNITION Issue new guidelines.	Accounting bulletin issued in December, 1999. Revision expected.	B
MATERIAL FACTS Issue guidelines to compel correction of deliberate factual misstatements claimed to be insignificant.	Issued August, 1999.	A
LIABILITIES FASB to issue better definition.	First of two reports may appear by fall.	C
ENFORCEMENT SEC to beef up.	Financial fraud task force set up June, 2000.	A
AUDIT COMMITTEES Strengthen role of such committees of corporate boards.	SEC issued new rules in December, 1999.	A

Data: Securities & Exchange Commission, BusinessWeek

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A SEAGATE COMPANY

on some very, very substantial matters, which the public will learn about shortly." They involve some of the largest companies in the country and the biggest accounting firms, he says.

Private groups are getting involved, too. At the behest of the SEC's Turner, Financial Executives International, an organization of financial

officers, on Apr. 26 issued guidelines aimed at reining in the ex-

actly, he has made some progress. Amazon included a reconciling pro forma and GAAP data in its latest results.

Still, cleaning up financial reporting won't be easy, given that the stakes for companies are so high. But so are the stakes for ordinary investors whose wealth and retirement prospects are ultimately on the line in the numbers game. Unless they and their advisers want to end up as thoroughly fleeced as Max Bialystock's rich widows, they need to pay a lot more attention to the numbers than they did during the bull market.

With Christopher H. Schmitt in Washington

Cover Story

cesses of pro forma reporting. At the New York Society of Security Analysts Inc., a discussion group has focused attention on the way Amazon reports its results. Gary Lutin, an investment banker and co-sponsor of the group, says: "I hope we are helping to accelerate the natural process of the cycle" back to reality-based financial reporting. Appar-

BusinessWeek online

For continuing coverage on corporate earnings, go to www.businessweek.com/today.htm

THE LAST WORD AT FIRST CALL

Charles L. "Chuck" Hill is a big man on Wall Street. The 6-foot-5-inch director of research at Thomson Financial/First Call is ringmaster to the frenzied circus of earnings reports every quarter. Stocks regularly soar or crater according to whether companies beat or fall below the per share earnings that Hill says are the consensus among brokerage analysts.

Hill, 63, aims to make his market-moving numbers credible by having all estimates calculated the same way. So he polls the Street's financial analysts to see how exactly they're working out their figures and enforces a standard, normally the one used by the majority. Getting everyone in line leads to a lot of screaming and shouting. "They'll be proactive in calling and yelling at you," says Lehman Brothers Inc. analyst Robert Rouse.

LIST MAKER. Tempers often run high because of the billions at stake. For starters, analysts often try to distinguish themselves from competitors and gain lucrative business by finding different ways to measure a company's results. But there are genuine differences of opinion about how to calculate earnings. Consider "one-time" gains and losses. Many analysts want to exclude them from regular earnings. They have a point, because such items generally don't reflect a trend. And not everyone agrees what "one-time" means.

The problem becomes acute when it comes to deciding how to treat companies' gains from their invest-

ments in other companies. Last year, chipmaker Intel Corp. said the large gains it made were ongoing and should be included in earnings. Some analysts disagreed strongly. "I was sympathetic with them," says Hill, himself a tech-stock analyst on the Street for 22 years. But the majority



TOUGH GUY: Hill keeps the numbers—and analysts—in line

wanted to do it Intel's way. Hill reluctantly adopted their view as the First Call standard.

Still a keen rugby player with a team of Harvard Business School alumni, Hill is tough with analysts he thinks are getting out of line. His sanctions can be deadly: He drops them from his A-list of analysts. The list, used by institutional investors to determine who offers useful opinions on stocks in which they're interested, is a powerful marketing tool for brokerages looking to earn trading commissions. Hill did just that to Rouse in a spat over the estimates of pharmaceutical researcher Quintiles

Transnational Corp. earlier this year. Rouse, like many analysts on the stock, was excluding its Internet spending. Says Hill: "I just thought it was outrageous."

His role in these debates gives Hill enormous power to determine what companies can pass off as earnings in their press releases. That leads critics like Rouse to contend that First Call should "present whatever analysts put out, not define what the formulas need to be."

CRUSADE. That was just what First Call was doing when Hill signed on as one of its first employees in 1991. Brokerage firms would use First Call to send analysts' reports electronically to clients all at once so that everyone would get the "first call" or what could be a stock-moving view.

It was because Hill found wide discrepancies in the figures that different houses were using that he decided to change things and began his long-running crusade for consistent numbers. These days, clients, too, demand a more sophisticated service. So Hill now churns out an array of services ranging from putting together Wall Street's collective insight on next year's earnings by companies in the Standard & Poor's 500-stock index to tracking how well estimates eventually match actual results. That's why he appears on TV and in the press so much—and why he's such a power on Wall Street.

By David Henry in New York

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Are you one of them?



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MONEY MANAGERS

FUNDS JUST AREN'T HAVING ANY FUN

Assets are way down—and a rocky market has exposed a host of industry problems

For most mutual-fund companies, it was the Big Easy. Even those handicapped by poor performers or bond-heavy portfolios had room to make a go of it in the bull market.

No more. Even if the stock market rallies on, the good old days are history. Like other industries, the yearlong bear market exposed a laundry list of ills in the asset-management industry, too—outdated business models, overcapacity, weak distribution, and overblown pay. “There are much bigger problems than the stock market,” says Chris J. Brown of Financial Research Corp., “like distribution, or the preponderance of mediocre products.”

Meanwhile, competition is as fierce as ever. New alternatives are moving in fast: Exchange-traded funds, index funds that trade on a stock exchange, gained \$66 billion last year, double the year before. Brokerage wrap programs—boasting tax efficiency and custom service—also saw assets double, to \$53 bil-

lion. This while fund companies are retrenching. Marketing budgets are getting slashed, analysts are receiving pink slips, and new fund offerings are being nixed: Wiesenberger Thomson Financial reports that there were 188 fund mergers in the first quarter of 2001, while a record 40 funds were shut down. Only 55 new funds were launched, down from 255 a year ago. Edward J. Boudreau Jr.—a former chief executive of John Hancock Funds Inc. and now an industry consultant—predicts that 50,000 jobs will be lost within a year from a workforce of roughly 750,000.

Trimming at the edges isn't enough. Glenn Schorr, senior analyst at Deutsche Bank Alex. Brown, says those who will thrive will have to pony up. The pressure is on to keep up with technology, broaden product mix, beef up distribution, and expand globally, where retirement markets will like-

ly boom. The scene favors survival of the fittest, the biggest as those with the most assets serves to pay Wall Street bankers more gain coveted space. “Small to midsize companies will get squeezed,” says Schorr, who estimates that industry profit margins will fall 30% to 40% this year. Prowling for part has begun: In April, Zurich Financial Services Group said it would seek a partner for Zurich Securities Funds, while Mellon Financial Corp. parent of the Dreyfus Funds, will acquire bond manager Standish, Ayer & Wells.

Wall Street hasn't lost faith yet. Asset management can be profitable as aging population supports higher investment demand. But if their investment strategy stopped working, their stock prices got clobbered. Shares of Stilwell Financial Inc., owner of the once-hot growth shop Janus Funds, plunged 18% last year, while perceived threats to T. Rowe Price's 401(k) business and its distribution constraints sent shares down 16%. Conversely, Franklin Resources' improved fund performance and broad asset base pushed the stock up 15% this year despite an 8% quarterly drop in price. The darlings are well-adjusted families that grow in any market. Federated Investors and Gabelli Asset Manager both raked in record profits and revenues last quarter via top-flight performance, the right blend of offerings, and an aggressive push into emerging international and high-net-worth markets. “If you want to be a big player,” says Thomas R. Donahue, president of Federated Investors Management Co., where 19% of 2001 sales have been in ballooning money-market funds, “you always have to have something to sell.”

The most urgent issue is the sharp drop in assets under management as assets fall, so do fees. That's proving companies such as Putnam Inv-

Money Out The Door

Largest net outflows of stock and bond mutual funds, First Quarter 2001

FUND COMPANY	OUTFLOWS BILLIONS	NUMBER OF FUNDS*	BEATING TARGET
JANUS CAPITAL	\$4.61	26	3
MAINSTAY FUNDS	1.68	23	5
DEUTSCHE ASSET MGMT.	1.22	29	4
ZURICH SCUDDER	1.20	59	5
T. ROWE PRICE	1.00	47	5
EATON VANCE	.937	17	4
AMERICAN CENTURY	.825	31	5

*Single share class

Data: Financial Research Corp.

nts to start streamlining. At the 4 fund company, assets fell one-fifth, \$321 billion, in six months through r. 30. On Apr. 11, it said it would off 256, or 4%, of its workforce. Five d managers also got the ax. Ana-s applaud the cutbacks, but say Put-n's link to financial advisers nation-le, who push Putnam funds for a mission, will go far to bail them out. The adviser tie-in is key. More in-tors have shed their do-it-yourself is and opted for hand-holding, espe-ly during the rocky market: Last r, nearly 84% of industry flows came through financial planners and bro-age firms, according to Strategic Inht. That's why T. Rowe Price's anchly held no-load philosophy has t growth. It caved last March and in-duced some load funds, which pay isers a commission to sell them. But wasn't enough to prevent the third-st net redemptions rate in the in-try last year. Poor performance n't help: Four of its largest funds ged behind the market last year.

T FOLLOWING. Fund families with-offerings for all seasons are also ler the gun. Janus Capital Corp. saw ets slump by \$100 billion in one year l first-quarter profits plunge 22%. wonder: Janus has 97% of its assets ech-heavy growth stocks. As 60% of v money went into value funds last r, Janus got broadsided. It now rts the worst outflows, after being top gainer in 2000 and No. 2 in 9. Schorr says it's too cash-strapped strike a deal with a partner and aden out to value funds. For now, Denver firm has cut 36% of its op-tional workforce, as it concentrates building a growing institutional busi-s. Luckily for them, a cult-like ap-l has helped to retain nearly all 6 lion retail shareholder accounts. Out-vs, as yet, only represent 2% of its 10 billion in assets.

Even companies with the wherewith-to buy out competitors are getting teezed. Alliance Capital bought San-d C. Bernstein Co. last October, to l \$80 billion in new, mostly value in-tments to its growth fund roster. t management fees are flat, and as-s have fallen by \$21 billion in the t quarter as market depreciation off-net inflows.

Mutual-fund families need to get their ancial house in order. Still, the best d to long-term performance is solid urns in bull or bear markets. As rulli Associates' Chris Brown says, you don't have strong-performing oducts that are currently in favor, ether growth or value, you're not en in the game."

By Mara Der Hovanesian

WHILE RIVALS STRUGGLE, FIDELITY SHARPENS ITS TECHNOLOGY EDGE

Privately held Fidelity Investments is trying to turn the mutual fund industry's malaise into a competitive edge. While rivals lay off workers and slash costs, Fidelity is betting big other firms are too strapped for cash to keep up with its deep pockets.

Technology will be a key weapon. Fidelity is upping its information technology budget 20% this year, to \$2.3 billion. The next generation of gizmos the company hopes will feed its \$855 billion investment machine was on preview at an InfoFest show on Apr. 24 for employees and a handful of outsiders. Abigail P. Johnson,

Shevlin, research director for online financial services at Forrester Research of Cambridge, Mass. "Some of their projects will succeed, some won't."

Shevlin is skeptical about wireless financial services, in which Fidelity is making a big push. One prototype product, called Natural Broker, requires next-generation cell-phone technology that's two years away from public release by Fidelity's own reckoning. Customers, using a hybrid personal digital assistant, will be able to make stock trades or request stock research using voice commands.

Fidelity is betting that Web TV, still a nascent technology, will spread

quickly in the next few years. This summer, it hopes to roll out interactive ads when Fidelity market experts such as Peter Lynch, former Fidelity Magellan Fund star, appear on TV. Viewers can click on the ad to order investment material or trade stocks at Fidelity's Web site.

A planned software tool could be a huge timesaver for investors. It "listens" to corporate earnings conference calls, flags keywords such as "operating earnings," and links to a Web site that lets a listener start from where the speaker mentions the keyword.

Automated services could prove to be winners. They range from instant messaging to help clients open new accounts online to software allowing customers to plug into financial-plans data from accounts at multiple financial institutions over the Web. A new "benefits portal" for corporate customers, who account for more than half of Fidelity's business, is already running. It lets clients manage all their corporate plans, even those not run by Fidelity.

If it all works, Fidelity could scoop up loads of business—providing its funds have good returns, too.

By Geoffrey Smith in Boston



PET IDEA **Heir apparent** Abigail Johnson is pushing tools to save investors time

JOHNSON AT FIDELITY'S RECENT INFOFEST

39, Chairman Edward C. Johnson 3d's daughter and heir apparent, was there to check on the progress of some of her pet projects. Now No. 2 at Fidelity's mutual-fund unit, Johnson says: "Technology leadership is an imperative for Fidelity."

WIRELESS SKEPTICS. Maybe so, but achieving it is not certain despite the big budget. Fidelity has not always been a technological leader in the financial-services industry. And while many of the 200 projects shown at Infofest are ambitious, some are also at an early stage. "Fidelity is the kind of company that throws things on the wall to see what sticks," says Ron

STOCKS

TECHNICALLY SPEAKING, THE MARKET LOOKS GOOD

Most technical analysts say the rally will continue

Technical analysts used to be the Rodney Dangerfields of Wall Street, for years calling one downturn after another while the market plowed ahead. But last year, they finally got respect. As most of the technicians predicted, stocks tumbled and continued their descent through the first quarter of this year. So what are the indicators telling them now? Is this current rally sus-

interest rates and Fed policy. Instead, they argue that outside factors can be reduced to things like volume, price, sentiment, and momentum. By analyzing such variables and matching emerging trends with past trends, it's possible to predict future price movements, since history tends to repeat itself. Richard H. Driehaus, a money manager who uses technical analysis, asserts that markets

According to Ralph J. Acampora, hyperkinetic Prudential Securities rector of technical research, the improvement in the A/D line means market's outlook is rosier. For months, beginning in April, 1998, the line went down even as the index were rising. "The A/D line reached low in March, 2000—the Nasdaq's t says Acampora. "Since then, breadth been improving," Acampora thinks rally is sustainable.

NARROW FOCUS? Still, there are b among the technicians. Salomon S Barney Inc. Vice-President Jonathan Lin argues: "The big picture is that A/D line has been trending down." current rally, asserts Lin, is a cyc rally within a secular bear market. " bull market is unwinding," says Lin change his view, volume would hav been healthier, buying force would hav



BULLISH INDICATORS

ADVANCE/DECLINE RATIOS The ratio of advancing issues on the N.Y.S.E. to declining issues on a moving average.

SENTIMENT The percentage of investors who describe themselves as bullish. A contrarian indicator: The smaller the percentage of bulls, the more bullish for the market.

RATIO OF NASDAQ-TO-NYSE VOLUME The gauge for the level of speculation in the market. A ratio of 2.0 is speculative; a ratio of 1.3 is considered healthy.

INDEX OPTIONS PUT-CALL RATIO The ratio of put options on the S&P 100 index to call options. A contrarian indicator: The greater the ratio, the more bullish for the market.

BEARISH INDICATORS

NEW HIGHS VERSUS NEW LOWS The number of individual stocks making new highs vs. the number hitting lows is still low.

NEW INDEX HIGHS The Dow, the S&P 500, and the Nasdaq still remain well below their highs.

Data: BusinessWeek

tainable, or is it just a bear trap?

For the moment, it seems the technicians are on the side of the bulls. Market internals such as the ratio of advancers to decliners, up-to-down volume, and investor-sentiment readings are positive, in stark contrast to the way matters stood a little more than a year ago. "We have seen an important low point," says Richard W. Arms Jr., whose Arms Index tracks the relationship between advancing and declining issues and the advance/decline volume ratio. "The market is moving higher."

Technical analysis is the study of the information generated by the internal workings of the market. Technicians pay little attention to such fundamentals as

"are more behavioral than science."

Richard McCabe, chief market analyst at Merrill Lynch & Co., homes in on the ratio of Nasdaq-to-New York Stock Exchange volume to gauge speculative activity. During the Nasdaq runup, that ratio was around 2 to 1 in Nasdaq's favor. Now it has fallen to 1.3 to 1. "That's a healthy sign," says McCabe.

There are other bullish indicators. Investor sentiment, a contrarian indicator, hit a low in March, a good sign for the market. And the all-important advance-decline (A/D) line has gotten stronger. In fact, before last year's market rout, technicians became bearish because the A/D line had turned negative. That divergence indicated a two-tiered market.

improve, and the indexes would have to be closer to their old highs.

Acampora says the bears, such as Lin, focus too narrowly on the divergence; ultimately, the broadening in the A/D line will be reflected in the Dow, which will not only return to its old high but also break through it.

For now, the bulls outnumber the bears. First Union Securities analyst Gregory A. Nye says that the market has been deeply oversold and the pendulum is starting to swing back. "Volume is coming in on the buy side," he says.

If the techies continue to call the market correctly, they may become new gurus on the Street.

By Robert J. Rosenberg in New York

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COMMENTARY

By Otis Port

THE FUTURE OF OPTICAL CHIPS IS NO ILLUSION

Fiber-optic technology has been badly bruised by Wall Street's pounding of the telecommunications sector. But dig beneath the gloom, and you'll find investors who say that the next generation of chip-based fiber optics will dwarf what is out there now. Call it the Chip Revolution, Part Two.

"It's like turning back the clock two-plus decades," says Michael A. Ricci, a vice-president at Intel Corp., to a time when today's Silicon Valley chip giants were barely teenagers. In the decades that followed, silicon paved the way to riches and fame for many chip managers and investors. Part Two should do the same. Only this time around, the focus will be on "optochips" that handle optical signals instead of electronic ones.

Intel is an opto-bull. Since the mid-1990s, the microprocessor king has bet some \$5 billion on so-called photonics. It has grabbed small stakes in 25 startups and taken over a half-dozen outfits—three of them in April. And Intel isn't about to pull in its horns. The telecom-parts business is growing at a 30% to 50% annual clip, explains Ricci, "and that's much healthier growth" than Intel's mainstay markets.

Optochip fever is raging at Morgenthaler Ventures. This Menlo Park (Calif.) venture-capital firm is the No. 2 backer, after Intel, of optical components startups, notching 15 of the 71 vc deals signed since 1996. Five have been inked so far this year, and partner Gary Shaffer expects to underwrite five or six more by yearend. "Some of these companies are so promising," he says, "that you want to reach for your wallet before they've finished their presentation."

Vcs know, of course, that new startups are more likely to fail than succeed. Even big-name stocks are never a sure thing. Lots of investors got burned by the sudden reversal at big optical players such as Lucent Technologies and JDS Uniphase.

Still, despite the risks in trying

to pick the next winners (table), the trend is clear: Optochips will do for telecom gear what microprocessors have done for computers. They will usher in vast increases in power, along with huge savings in costs. Today, most fiber-optic equipment is assembled from a bunch of separate modules. That's expensive. For example, an optical amplifier that rejuvenates signals within fiber-optic networks is the size of a microwave oven and costs \$20,000. But when the same task can be performed by little "op-amp" chips, the cost should drop to \$100, says Alan Huang, founder of Menlo Park startup Terabit Corp. and a former photonics researcher at Lucent Bell Laboratories.

Right now, some of the hottest op-

tochips are miniature counterparts of yesteryear's plug-in switchboards. These chips typically connect calls using teensy mirrors that tilt to direct the laser beam coming out of one optical fiber into another. Such optical switches are much simpler and faster than existing switches, in which the incoming beam is converted into electronic signals, routed by silicon chips, then converted back into photonic pulses.

LASER'S EDGE. Optical switches, however, are just a warm-up for the main act: multifunction optochips. A few companies already combine two functions, such as a laser with a "modulator" that chops the beam into pulses. "Now, we're starting to see integration that merges three and four functions," says Morgenthaler's Shaffer. Because one of these chips will replace 100 discrete devices, he adds, "they're going to kick butt over the next 20 to 30 years."

Materials are also due for an overhaul. For tomorrow's ultra-fast switching speeds of 40 billion bits (40 gigabits) per second, optochip makers will turn to exotic semiconductors such as indium-phosphide, says Todd A. Brooks, a partner at Mayfield Fund, another Menlo Park venture capitalist. Today, only a few companies have much experience making indium-phosphide chips. The leaders are aerospace companies like TRW Inc. and Hughes Electronics Corp., which pursued nonsilicon chips because they can withstand the rigors of space. But Brooks says some silicon chipmakers are now looking to convert chip plants to indium.

So don't be fooled by the opto-pessimism on Wall Street. The layoffs at big, old-line companies are hogging headlines and souring the outlook. But the all-optical technologies being hatched by dozens of startups will ultimately clear the gloom. A second chip revolution is coming.

Seeing the Light

Since 1996, venture funding in photonics has jumped 100-fold, to \$6.4 billion.

Some of the hot startups:

COMPANY	PRODUCT
AGILITY COMMUNICATIONS	"Tunable" lasers that produce various colors
CALIENT NETWORKS	All-optical switch with huge capacity
INARA NETWORKS	All-optical switch for multimedia signals
LIGHTWAVE MICROSYSTEMS	Laser waveguides and plastic optochips
NEW FOCUS	High-power tunable lasers
OPTICAL MICRO-MACHINES	All-optical optochip switches

Data: VentureOne, Lightreading.com, Morgenthaler Ventures



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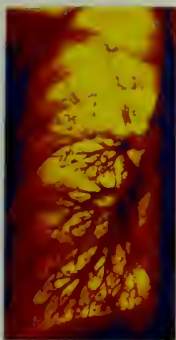
ARTIFICIAL LUNGS: BREATHING EASIER?

A SIMPLE ACT like breathing is already impossible for roughly 1,000 Americans suffering from severe respiratory ailments such as emphysema and chronic fibrosis. Many patients could be helped by an artificial device is being tested of lungs

powerful enough to circulate oxygen to the body's tissues while expelling carbon dioxide. However, it has proved extremely difficult to design such a device. Now, Dr. Jack G. Hattler, a surgeon at the University of Pittsburgh, says that he has developed an implantable apparatus that works in cows. Human testing should begin later this year in Europe.

Hattler's device involves a multiple catheter to which about a thousand tiny fiber membranes have been attached. A vacuum outside the patient's body pumps pure oxygen into the catheter. When the oxygen reaches the fibers, it is forced out into the bloodstream by a balloon. Carbon dioxide, meanwhile, is absorbed and cleared by the fibers' semipermeable membranes.

Because human lungs are so densely packed with small air sacs, the total surface area of a pair of lungs is roughly the size of a tennis court. Hattler's device has about the same surface area as the cover of this magazine. Nonetheless, tests on animals indicate that the machine can handle about 50% of a normal lung's function—good enough, says Hattler, to ease the burden on a patient's damaged lungs, giving them a chance to heal. □



HUMAN LUNG: An artificial device is being tested of lungs

MINING ELECTRICITY

PUNDITS FROM NEW YORK to California grimly predict that as fuel demand outpaces supply, summer's soaring temperatures will trigger costly blackouts and sharp increases in utility rates. One futuristic solution, weirdly enough, may literally be a lot of hot air.

Houston-based CAES Development Co. has teamed up with researchers from Sandia National Laboratories to design a power plant that generates cheap electricity from compressed air. The 2,700-megawatt facility, which is expected to begin opera-

tions in 2003, will eventually generate enough power to light up about 700,000 homes. It will be built in an abandoned limestone mine in Norton, Ohio, about 35 miles south of Cleveland.

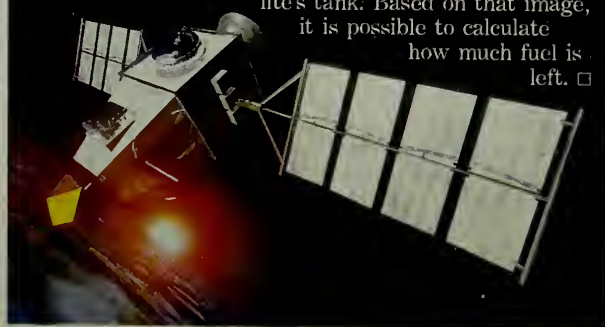
To generate its inexpensive power, the CAES plant will run compressors nightly and on weekends, when electricity is relatively cheap. Then, in times of peak demand—weekdays between 6 a.m. and 10 p.m.—air will be released from the 540-acre mine and heated, at a small incremental cost. The hot air would then be forced through a series of turbines to generate power that can be sold back to the utility grid. Construction of the new plant will commence in the fall. □

KNOWING WHEN THE SATELLITE IS RUNNING ON EMPTY

COMMUNICATIONS SATELLITES MUST USE ROCKET FUEL to maintain the precise positions required to transmit phone signals from, say, San Francisco to New York. To sidestep this problem, telecom companies routinely replace the birds before they run out of fuel. But switching off a satellite prematurely can cost millions in unrealized revenues.

Scientists at Purdue University and Lockheed Martin's Space Systems Co. are using a computer program initially designed to understand soap-bubble formation to keep satellites flying up to a year longer. The program gauges fuel levels more accurately than existing bookkeeping methods, which estimate consumption by tracking the duration of all rocket firings in orbit. The new software instead relies on temperature data.

Because rocket fuel freezes in outer space, all satellites are equipped with small heaters and sensors that monitor fuel temperature. Empty areas heat up faster, so temperature information provides a three-dimensional picture of where fuel is located inside the satellite's tank. Based on that image, it is possible to calculate how much fuel is left. □



THE BODY'S FIRST LINE OF DEFENSE AGAINST CANCER

RESEARCHERS HAVE KNOWN for some time that certain drugs can rouse the immune system to fight off cancer. But there has never been proof that the immune system can actually prevent tumors from forming in the first place—until now.

In the Apr. 26 issue of *Nature*, a team of scientists from the Washington University School of Medicine in St. Louis and the Memorial Sloan-Kettering Cancer Center in New York present some of the strongest evidence to date that the body's natural defenses actually guard against the disease.

To elucidate the role of the immune system, the researchers studied what happened when normal and immuno-compromised mice were injected with huge doses of a chemical carcinogen called MCA. Up to 72% of the immuno-deficient mice rapidly developed cancers. In contrast, only 19% of the normal mice developed tumors. Based on the data, the researchers concluded that lymphocytes and other components of the immune system must work together to kill off malignant cells.

Additional studies indicate how this process might happen. By transplanting tumor cells from one mouse to another, the scientists discovered that the immune system filters out certain types of tumor cells. It then goes on to alter other cells based on what it has learned—a process known as immunoeediting. Irene M. Kunii

DUMPING
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BusinessWeek Investor

Taking the Measure Of a Stock

Discounted cash flow tells what other methods don't

BY CAROL MARIE CROPPER

In July, 2000, as Ariba soared above \$130, Aswath Damodaran, a New York University finance professor, decided the Internet software company was worth a little more than half that—a valuation that has since proved far too generous. What did Damodaran know that the stock market didn't? A better question might be: What method did he use to value the stock that gave him an answer so different from the market's?

While sell-side stock analysts were using price-to-sales ratios to justify high-flying prices—often dividing the price by a sales number bloated on wildly optimistic projections—Damodaran and others like him slogged through something called the discounted-cash-flow model. The method takes a lot more work than simply dividing a stock's price by its per-share sales or earnings, then deciding if the result is reasonable. But for your effort, you get a picture of how such variables as future growth and interest rates will affect the value of the stock. Also, instead of trying to come up with a company's value, some use the model as a reality check, plugging in the current stock price to calculate how fast a company would have to grow to justify it.

TIME-TESTED. Discounted cash-flow models aren't an untested device frantically developed in the aftermath of last year's market bubble. Money managers and academics have been using them for decades, coming up with numerous variations: the dividend-discount model (best suited for companies paying dividends), the free-cash-flow-to-the-firm model, and so on. Investment bankers also use these models to price companies involved in mergers or acquisitions.

The models, with their various permutations, are all an attempt to do the same two things: First, they look at factors such as growth rates and profit margins to project how much money a

company can generate in the future. Then, they discount that cash to come up with a present value. How much of a discount depends on the interest rate available from a risk-free investment, the company's cost of capital, and the riskiness of the stock.

What these models really give you is an appreciation for what drives stock values. Changes in the long-term growth rate seem to have the greatest impact on growth companies, with next year's earnings projection and, of course, changes in interest rates, also making a big difference.

Stocks

Consider the numbers generated by the discount model offered by Bloomberg Financial Markets (table). McDonald's, which recently traded in the market

at \$27.50, is valued at almost \$24, making it a little overpriced. The model assumes a long-term growth rate of 11.5% and projected earnings per share next year of \$1.70. Cut the growth rate 30%, and Mickey D's valuation plunges to \$17; the growth rate 30%, and the stock value climbs to \$34. In a like manner, raising interest rates one percentage point shoves the valuation down to \$18; a one percentage point drop boosts the value to about \$35.

Manually working through all these numbers might bring back bad memories of math class. Although Bloomberg's helpful model is available only to those paying \$1,600 or more a month





work through their own valuation model. (The book costs \$29.95 and is published by The McGraw-Hill Companies, which also publishes *BusinessWeek*.)

The ValuePro model is relatively simple (table, page 124). Type in a ticker symbol, and the model will come up with appropriate figures drawn from the company's financial statements, analysts' earnings forecasts, and the stock and bond markets. Of course, you may want to change some of the inputs, particularly the growth rate, which is based on Wall Street analysts' often too-optimistic forecasts. For JDS Uniphase, a maker of optical networking equipment, analysts predict 33% earnings growth, despite the meltdown in the telecom sector, the main customer for its products. Cut the JDS growth rate in half, and the model slices the stock's value by two-thirds.

GARBAGE IN? Even with a relatively simple model such as ValuePro's, the investor's ability to make good projections is absolutely critical. "Theoretically, the discounted-cash-flow model is the perfect measure," says Bala Iyer, director of quantitative research at Banc One Investment Advisors. "The problem with it is that it relies a lot on forward-looking forecasts, and because of that it's susceptible to error."

That's not the only problem. The model isn't suited for short-term investing—since it focuses on long-term value. And just because the model says a stock is worth \$50 doesn't mean it will trade for that anytime soon. Using a good cash-flow model may help you avoid buying into a bubble, but it might make you miss those big runups that can be profitable (if you sell at the peak). Also, focusing too much on just numbers might cause you to overlook an unusual opportunity like, say, Microsoft a dozen years ago. The company never looked cheap, but its ability to dominate the PC software market made it a financial powerhouse and investor's dream.

With all the caveats, Damodaran still argues that discounted-cash-flow models make the best valuation tools. He says analysts who rely on

First, all of these models project how much money a company can generate in the future. Then, they discount that cash to come up with a present value

s financial information service, fortunately are also a few free Web sites with valuation models. They let investors simply plug in the numbers or adjust ones already there. The programs then complete the calculations. Damodaran's Web site (www.stern.nyu.edu/nodan/) might seem a bit too much like a look for some investors. But it's a feast for valuation buffs. He offers nine different discounted-cash-flow models set up in Excel spreadsheets. There's also informational material explaining the nuances of the models and telling

how to estimate the various inputs. And if discounted-cash-flow models aren't enough, there are sections on other approaches to valuation. For most investors, ValuePro will be easier to use. It's only one model, and it's on one page. The site, also set up by Gary Gray, a teaching professor at Pennsylvania State University. He, along with two other Penn State faculty members, Patrick Satis and J. Randall Woolf, wrote *StreetSmart Guide to Using a Stock*, a useful guide for investors who want to

Adjusting The Variables

This shows stock-price changes using the discounted-cash-flow model. Such methods let investors play a "what if?" game, trying to figure out what happens to values if fundamentals shift.

	MCDONALD'S	MICROSOFT	DELL
Recent Price*	\$27.50	\$67.75	\$26.24
Interest Rate Falls 1 Point	34.63	47.34	30.32
Interest Rate Rises 1 Point	17.70	24.21	15.43
Next Year's EPS Rises 50%	35.92	49.64	31.89
Next Year's EPS Falls 50%	12.11	16.60	10.71
Long-term EPS Growth Goes Up 30%	33.83	56.60	39.07
Long-term EPS Growth Goes Down 30%	17.01	18.88	11.17

* Apr. 30

Data: Bloomberg Financial Markets

price-earnings ratios also make assumptions about growth when they decide what p-e is justifiable for a stock. They just don't bother doing it explicitly. Without weighing all the elements that are in the discounted-cash-flow model, says Damodaran, valuation becomes a beauty contest—with stocks compared with each other rather than judged on intrinsic value. "If the companies you are comparing your company to are all overpriced," says Damodaran, "what you end up with is a stock that drops by 60% or 65%." That's something easier to imagine now than it was two years ago. Besides, he says, focusing only on earnings puts investors at the mercy of companies adept at jiggering the bottom line. Cash flows are more difficult to manipulate.

It's the sell-side analysts—the talking heads most likely to pop up on cable TV—who are enamored of relative valuation methods such as

price-earnings and price-sales ratios, Damodaran says. The same firms' money managers, serving their well-heeled private clients, may opt for more conservative valuation methods. Christopher Wolfe, an equity strategist at JPMorgan Private Bank, which manages \$310 billion for rich investors, says its discounted-cash-flow model alerted its portfolio managers last year to the tech-stock bubble. "Unfortunately, our sell side was very aggressive," he said.

SHIFTING SANDS. Even its strongest advocate says discounted cash flow is no sure bet. And a moving target as well. If the company blows latest quarterly earnings, if its major customer files for bankruptcy, or if interest rates take a dramatic turn, you have to rerun the numbers. Says Damodaran: "Any time your expectations change, your stock's value is going to change."

Remember Damodaran's valuation of Ariba at \$7.73? The stock recently traded at \$7.73, although the profit now estimates it's worth about twice that. Keep in mind that an investor using a cash-flow model would have bought Ariba when it was trading in triple digits. A tool that helps you skirt disaster is that is extremely valuable. If you don't believe it, ask an investor who chased Ariba at \$130.

How To Run the Numbers

This model is free—and available at www.valuepro.net. When you enter a ticker symbol, the page below will come up with all 21 boxes filled in.

Many of the inputs come from company financial statements—and generally need no revision. Others, however, involve judgments about a company's prospects that you may want to adjust to reflect your own outlook. This page shows the numbers for JDS Uniphase.

ValuePro.net Online Valuation

ValuePro Home

Cash Flow Details

Custom Valuation

Online Valuation for JDSU - 4 / 27 / 2001

Intrinsic Stock Value 32.67

Recalculate

Value Another Company

Excess Return Period (Yrs)	10	Depreciation Rate (% of Rev)	3.66
Revenues (\$mil)	1986.8	Investment Rate (% of Rev)	19.37
Growth Rate (%)	33.00	Working Capital (% of Rev)	39.28
Net Oper. Profit Margin (%)	34.59	Short-Term Assets (\$mil)	1972.9
Tax Rate (%)	33.97	Short-Term Liab. (\$mil)	567.2
Stock Price (\$)	23.31	Equity Risk Premium (%)	3
Shares Outstanding (mil)	935.93	Company Beta	1.6275
10-Yr Treasury Yield (%)	5	Value Debt Out. (\$mil)	41
Bond Spread Treasury (%)	1.5	Value Pref. Stock Out. (\$mil)	0
Preferred Stock Yield (%)	7.5	Company WACC (%)	9.87

EXCESS RETURN PERIOD (IN YEARS)

This shows how long the company can earn high returns. For companies with high-margin, high-growth businesses, that number may be 7 or 10 years. For low-margin, more mature companies, use 1 to 5 years. For technology, with its rapid change, it might be better to use 5 to 7 years.

GROWTH RATE (%)

The number here is based on Wall Street analysts' forecasts of growth in earnings per share, which usually are optimistic. If you expect growth to be less robust, lower this number.

STOCK PRICE (\$)

Remember to update this to the latest closing price, since the Web site may not

10-YEAR TREASURY YIELD (%)

This needs updating, too. If you think interest rates are going to move up or down, plug in some different numbers to see how that changes the stock's value.

EQUITY RISK PREMIUM (%)

This is the return above the 10-year bond rate that you want for the additional risk of the stock market. The default rate is 3%, but that's historically low. If you think stocks are riskier than before, raise this to 4% or higher.

COMPANY BETA

This is a measure of a stock's price volatility, or riskiness. A beta of 1 means the stock has the same volatility as the overall market. Since tech stock is more volatile, they have betas. More stable or mature companies will usually have betas of less than 1.



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Hasta la Vista, Baby

When to dump a mutual fund

BY LEWIS BRAHAM

Did your jaw drop when you read your latest quarterly mutual-fund statement? The past year has been so brutal, many investors are paralyzed with fear. But if your funds are seriously underperforming, you can't just sit there. You must sell. "Selling is a bad word in the investment world," says Edward Foster, chief investment strategist at Fabian Investment Resources, an in-

vestment advisory firm in Huntington Beach, Calif. "But in order to take control of your financial life, you need to have a sell discipline."

If you're like most investors, you fall into one of two camps. You sell at the first sign of negative performance or you hold on for dear life, no matter what happens. Both strategies are flawed because they're based on an emotional response instead of a rational assessment of performance.

What you should do is buy or sell a fund based on its performance relative to its peer group. "We compare a small-cap value fund's return to other small-cap value funds and the Russell 2000 Value Index," says investment adviser Louis Stanasolovich of Legend Financial Advisors in Pittsburgh. That way you can sort out funds that are down because they invest in an unpopular sector from the true laggards.

The timing of the sale is also important.

According to a study conducted by the Schwab Center for Investment Research, investors who sold and replaced loser funds after just one year of underperformance garnered a 13.4% annualized return from 1987 through 1996. If you waited three years to sell, your return fell to 12.5%. Stanasolovich improves upon this formula. He'll "watchlist" a fund to sell if it lags its peers three straight quarters. That way,

he doesn't punish funds with only one bad quarter. **"LEMON LIST."** By those standards, plenty of funds are worth dumping. A screen run by Morningstar of funds with more than \$1 billion in assets found 141 potential sells. The poorest performers (table) were Putnam OTC Emerging Growth, Morgan Stanley Dean Witter High-Yield Securities, and Janus Enterprise, lagging by 5.1, 29.2, and 28.9, respectively. If the performance lag is small, you may want to hold for an additional three quarters to see if there's any improvement. But there's no reason to keep Putnam OTC Emerging Growth. "This fund has lost investors money on a one-year, three-year, and five-year basis," says Foster. "There's still \$3.5 billion invested in it." Because of that track record, Putnam OTC tops Foster's "lemon list" of sell-worthy funds, which is available free if you register at www.fabianlive.com.

In the previous case, you would sell Putnam OTC and buy a better mid-cap growth fund, so you don't miss any upside in that sector. On *BusinessWeek's* Web site, you can search for

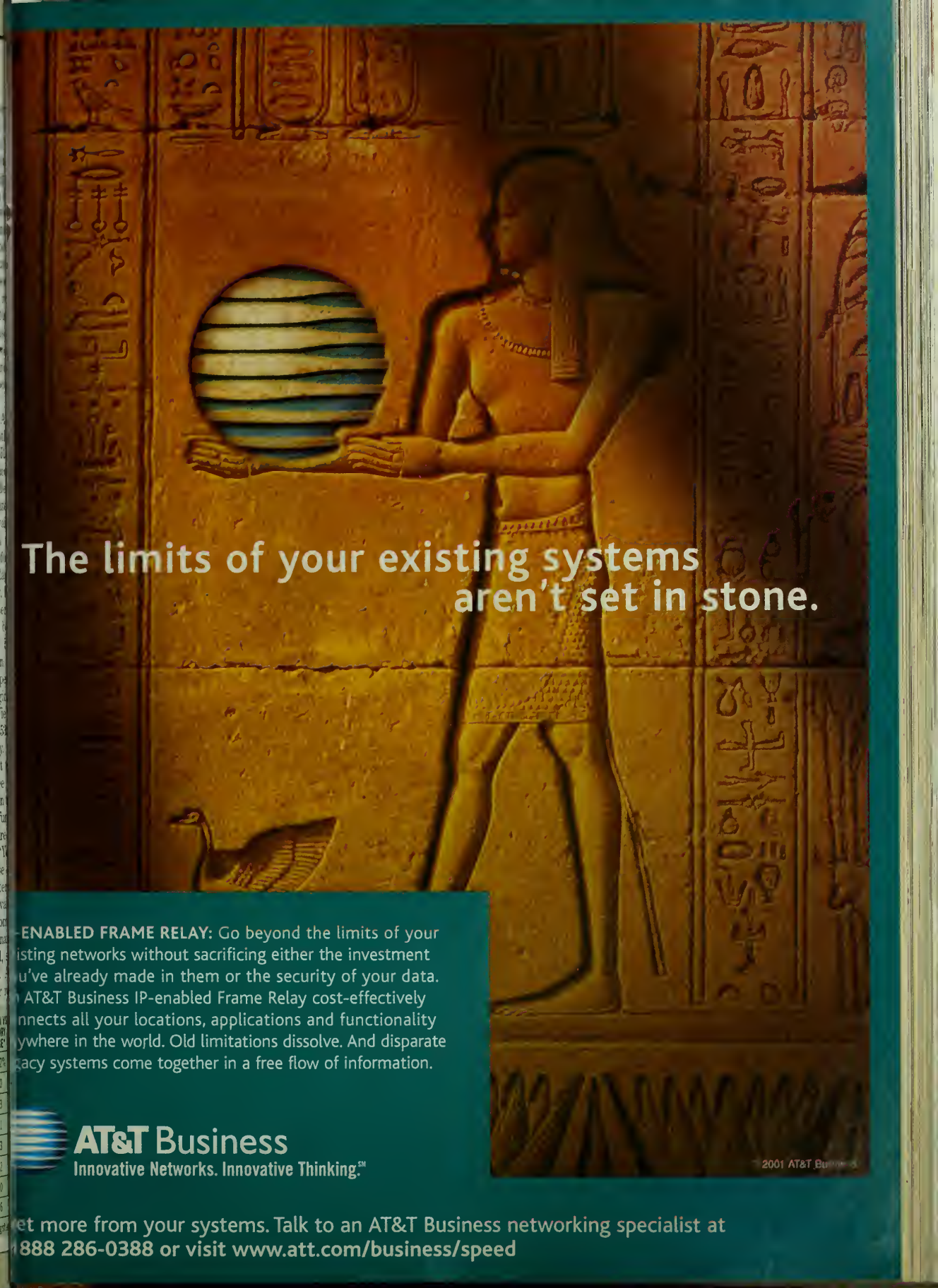
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FUND/SYMBOL	CATEGORY	RETURN VS. CATEGORY AVERAGE*	FUND/SYMBOL	CATEGORY	RETURN VS. CATEGORY AVERAGE
PUTNAM OTC EMERGING GROWTH A/POEGX	Mid-cap Growth	-53.5%	AMERICAN CENTURY EQUITY GROWTH/BEQGX	Large-cap Value	-25.2%
MSOW HIGH-YIELD SECURITIES D/HYLDX	High-yield Bond	-29.2	PBHG GROWTH/PBHGX	Mid-cap Growth	-25.0
JANUS ENTERPRISE/JAENX	Mid-cap Growth	-28.9	PUTNAM INTL. NEW OPPORTUNITIES A/PINOX	Foreign Stock	-24.3
FIDELITY AGGRESSIVE GROWTH/FDEGX	Large-cap Growth	-28.7	FIDELITY OTC/FOCPX	Large-cap Growth	-24.1
JANUS VENTURE/JAVTX	Small-cap Growth	-27.1	PUTNAM VOYAGER II A/PVHIX	Mid-cap Growth	-23.3
WADDALL & REED RETIREMENT A/UNFDX	Domestic Hybrid	-27.0	RS EMERGING GROWTH/RSEGX	Mid-cap Growth	-23.2
USAA GROWTH/USAAH	Large-cap Blend	-25.5	OPPENHEIMER GLOBAL GR. & INC. A/OPGIX	International Hybrid	-23.0
FEDERATED EQUITY-INCOME A/LEIFX	Large-cap Value	-25.3	PUTNAM GLOBAL GROWTH A/PEQUX	World Stock	-22.6

*The fund's total return relative to similar funds over the three quarters ended Mar. 31, 2001

Data: Morningstar



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Two red flags:
Funds that are so
big they're no
longer nimble, and
those beset by
"style drift"—
former small- and
mid-caps that now
buy large caps

placements. Go to businessweek.com/investor/funds.html. Click on the Interactive Mutual Fund Scoreboard. Select "Equity Funds" for "Fund Type," "Mid-cap Growth" for "Display," and "BW Ratings" for "View." The ratings, which run from A to F, are based on the past five years' risk-adjusted total return. Among the options: Calamos Growth and Vanguard Capital Opportunity.

LUMBERING GIANTS. Why do funds underperform? Poor investment choices, for sure, but sometimes they are exacerbated by "asset bloat"—the fund is just too big to be nimble. In fact, a good way to avoid future laggards is by selling oversize funds. How big is too big? It depends on investment style. According to one study by Morningstar, at small- and mid-cap growth funds that trade aggressively, performance starts to decline after assets pass \$150 million; at large growth funds, \$4 billion. Value funds that buy and hold can grow larger before sluggishness sets in.

Many large, aggressive growth funds have cost their shareholders dearly. They include Fidelity Aggressive Growth, Fidelity OTC, Putnam New Opportunities, MFS Emerging Growth, and Janus Enterprise. All have more than \$4 billion

under management and have underperformed their peers by more than 18% over the past three quarters. They started as small- and mid-cap funds but now buy large stocks that are easier to trade. Such "style drift" is another reason to sell, especially if you own other large-cap funds.

Portfolio manager Jim Goff of Janus Enterprise says it isn't asset size that hurt performance but the market punishes his tech and telecom stocks, such as Crown Castle International and Telecommunications. "They have strong fundamentals, but they have been dragged down by the technology association," says Goff. Perhaps, yet sister fund Janus Orion Fund, with only \$1 billion in assets, has beaten Enterprise handily in the past three quarters, and it's heavily invested in those sectors.

Both Fidelity and MFS argue their lagging funds are much more aggressive than their peers in the large-cap growth category. Jessica Catino, a Fidelity spokesperson, says Fidelity OTC should be compared with the Nasdaq Composite Index, which it has beaten in the past year but lagged over the past decade. Putnam offers no explanation for the current lag at its funds, but noted that their 10-year track records were good. Yet a smaller, more nimble rival such as Bridgeway Aggressive Growth Fund is just as aggressive and has beaten all of these funds on a one-, three-, and five-year basis. Why stick around?

A management change can be a sell signal, not always. In a laggard, such as Morgan Stanley Dean Witter High-Yield Securities, it could be a blessing. This January, the firm replaced Peter Avelar with Stephen Esser, the top-performing manager of MAS High-Yield Institutional Fund. Esser might improve returns, but management changes bring other issues. If the new manager dumps the prior manager's holdings, you can hit with a large capital-gains distribution.

When you're dealing with taxable accounts, selling is a little dicier. If you have unrealized gains in the fund, you have to weigh the consequences of selling against the opportunity cost of holding on to a laggard. If you have realized losses in a fund, you should sell it and use the losses to offset capital gains at other funds.

Ideally, you should have a sell discipline in place before buying a fund. "When funds go down isn't the time to figure out when to sell," says Foster. By setting performance boundaries beforehand, you can get out before losses become unbearable.

Bloated Growth Funds

Returns can suffer if funds get too large

FUND/SYMBOL	ASSETS* BILLIONS	RELATIVE PERFORMANCE**
PUTNAM NEW OPPORTUNITIES A/PNOPX	\$18.9	-22.1%
JANUS TWENTY/JAVLX	17.7	-15.9
MFS EMERGING GROWTH B/MEGBX	15.5	-18.2
FIDELITY AGGRESSIVE GROWTH/FDEGX	12.3	-28.7
FIDELITY OTC/FOCPX	9.2	-24.1
PUTNAM VISTA A/PVISX	7.3	-10.9
AIM WEINGARTEN A/WEINX	6.6	-16.6
AXP GROWTH A/INIDX	6.3	-16.0

* Total assets for all share classes combined **The fund's total return relative to similar funds over the three quarters ended Mar. 31, 2001
Data: Morningstar

BusinessWeek online

For a complete list of laggards, go to the May 14 issue online at www.businessweek.com

You deserve a factual look at...

"Greater Israel"

Does it have any relation to reality?

There are strident requests by the Arab countries, by the Palestinians, and indeed by much of the world that Israel should once and for all abandon its dream of a "Greater Israel." Israel's alleged expansionist ambitions have long been a staple of Arab anti-Israel propaganda. But what does it really mean? Does it have any relation to reality?

What are the facts?

Stripes on the Flag. Arab propaganda has it that the two stripes on the flag of Israel, above and below the star of David, represent the Nile and the Euphrates River, respectively, and signify Israel's expansionist desire, to form an "empire" that would supposedly reach from Cairo to Baghdad. But that has no basis in fact, of course. Nowhere in any documents of the Jewish state, in any statement by even the most "radical" spokesman

can reference to anything like that be found.

Israel's Borders. "Palestine," part of the Ottoman Empire before World War I, came under British mandate after that war. The Golan Heights were part of Palestine. Israel's current borders are the result of the 1948 War of Independence, in which six Arab armies invaded the new-born state, but were utterly defeated, and the 1967 Six-Day War, in which those same armies once again invaded Israel. In that war, Israel conquered the Gaza Strip, the vast Sinai Peninsula, and the Golan Heights. And Israel also *repossessed* the provinces of Judea/Sumaria, (the "West Bank"), and the eastern part of Jerusalem, which had been occupied by the Jordanians nineteen years earlier, when they invaded the just new-born Jewish state. In order to achieve peace

with Egypt, Israel returned to it all of the Sinai. Israel is and has always been prepared to grant full autonomy to the Arabs living in Judea/Sumaria. It is clear to all knowledgeable in military matters that, for immutable strategic reason, Israel cannot for any foreseeable future abandon or yield military control of Judea/Sumaria (the "West Bank") and of the Golan Heights.

The Myth of Greater Israel. Israel is one of the smallest countries in the world.

Most people don't realize how small it really is. One wonders whether those who keep talking about "Greater Israel" and who wish to pressure Israel to divest itself of a big chunk of its territory are aware of it. A look at the map is revealing. Including the vaunted "West Bank," the Gaza Strip and the Golan Heights, the

Israel	France	California	Syria	Ecuador
10,840 sq. mi.	213,673 sq. mi.	160,222 sq. mi.	72,209 sq. mi.	110,688 sq.



Greater Israel? It's a myth. See for yourself!

entire area of the country is barely over 10,000 square miles. France is twenty times as large as Israel, California fifteen times as large, Syria about seven times as large, and "tiny" Ecuador ten times as large. Israel is so small that its area is less than half the size of San Bernardino County, California; if it were dropped into Lake Michigan it would disappear from sight without a trace. The Arab counties in contrast are huge—they occupy twice the area of the United States. Greater Israel, indeed!

It is clear that the concept of "Greater Israel," lacks any validity and has no basis in fact. To apply such a concept to a country as small as Israel would almost seem a mockery. Obviously, Israel has no territorial ambitions. All it wants is to live in peace within secure and defensible borders, just as any other country and as required under U.N. Resolution No. 242. But it seems that the size of Israel, whether "greater" or "lesser" is not at all the concern of Israel's implacable Arab enemies. The very *existence* of Israel, of a Jewish state in their midst of whatever size, is unacceptable to the Arabs. And unless that mindset changes, not until the Arab states have become democracies and have come to full acceptance of Israel, are willing to make *true* peace with it, and are prepared to establish normal and friendly relations with Israel can any possible territorial adjustment be considered. As it looks right now, that may still take some time.

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WHEN DO-IT-YOURSELF ISN'T GOOD ENOUGH



BY TODDI GUTNER

Whipsawed by the market, more and more investors are seeking out financial advisers. But men and women don't always have the same expectations

My husband, Neil, and I have always considered ourselves sophisticated, do-it-yourself investors. We exhaustively research investments, then match our moderately high tolerance for risk with our long-term goals of funding our kids' college education and saving for retirement. We thought financial advice was for investing neophytes; what could we learn that we couldn't find out for ourselves?

Well, that thinking only got us as far as the end of the bull market. With our portfolio down more than 30% last year and this year's negative returns mirroring the market, I began to question our ability to meet our financial goals. I'm not alone. Last year, the National Association of Personal Financial Advisors reported a 35% increase in the number of people seeking advisers, and this year they're on track to see the same.

ENDLESS OPTIONS. I decided that my husband and I needed a financial checkup. While we had recently bought a home, drafted wills, and increased our life and disability insurance, we had no real plan as we blindly socked away money for the future. We have several separate and pooled accounts, both taxable and nontaxable, but we're hazy as to the overall allocation of our assets. Should we shift some of our longtime growth funds into recently higher-earning value funds? Are there any tax-saving strategies we need to consider? Should I invest aftertax dollars in an individual retirement account? Will we have enough money to retire in 15 years, maintain our lifestyle, and travel? These were just some of the questions I thought about.

Neil didn't think we needed advice. In his

mind, as long as we were saving the maximum on our retirement plans, and then some, we'd be fine. But my financial anxieties got the best of him, and he agreed to see an adviser. I immediately got to work trying to find someone before he changed his mind.

The options seemed endless—certified financial planners, personal financial specialists, chartered financial consultants and analysts, registered investment advisers, money managers, and more coaches. I asked everyone I knew for a recommendation of someone they knew who provided investment and financial advice. I ended up with four names and called them.

TRUST. Rather than focus on a person's professional title, I looked for someone who could

address our specific questions. While most of my concerns are fairly universal, we needed to address the complexities of how to handle income from the sale of family business. Over the phone, I asked about advisers' backgrounds, how long they had been in business, how they were compensated, what services they provided, what kinds of clients they served, how often we would meet, and whether there was a minimum account fee or investment, among other things.

I particularly liked a candidate, but wanted an opinion of our portfolio without investing the minimum \$300,

he normally requires of a client. I asked if we would consider a one-time financial checkup with the possibility of managing some money in the future. After some negotiation, he agreed to view our asset allocation and make recommendations for a \$750 consulting fee.

I'm busy getting our financial files in order for our mid-May meeting. I know my husband and I have different goals and expectations. I want someone I can return to for ongoing advice on perhaps future money-management services. He's looking for a one-time analysis. "Women choose a financial adviser for a long-term relationship with someone they can trust. They see the adviser playing a significant role in making the investment decisions," says Bridget Macaskill, chairman and CEO of Oppenheimer Funds. "Men see themselves as in control of investment decisions, building a trusting relationship is less important." That's certainly the case in my family. But I figure it's one step at a time.



Advice for Finding An Adviser

KNOW WHAT YOU NEED Be clear about what you expect to get from your adviser.

NETWORK Often, the best advisers are the ones others have used and can recommend.

INTERVIEW SEVERAL CANDIDATES You're a consumer—shop for the person who has the experience and background you need.

NEGOTIATE THE COST Assume there is some flexibility in the fee structure.

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WHAT'S INSTINET WORTH TO YOU?



BY ROBERT BARKER

The pioneer electronic stock-trading network is a survivor, and its IPO will allow investors to name the price they are willing to pay

Before Archipelago, before Island ECN, before even Nasdaq, there was Instinet. Since 1969, this pioneering electronic stock-trading network has given institutional investors the power to swap shares directly. Without having to send their orders on circuitous routes past toll takers on Wall Street's exchange floors and trading desks, Instinet's clients often can save money and time. Demand for the service keeps running high: Revenues last year leaped 48%, to more than \$1.4 billion (table).

Now, even small investors are noticing Instinet. With clever TV ads on CNBC and CNN featuring a matador and live market updates from its Manhattan headquarters, it's taking a higher profile. Next step: an initial public offering. Reuters Group, Instinet's owner since 1987, aims by June 30 to sell 12.5% of Instinet for an estimated \$12.50 a share, or \$369 million.

Good deal? Could be, but as usual it will depend on the price. Happily, with this IPO, prospective

investors have two circumstances working in their favor. The IPO market remains sickly, limiting the price that Reuters, which stands to take \$150 million of the deal's proceeds, can win for Instinet. Better yet, because of Instinet's link to an unusual new underwriter, small investors can specify the price they're willing to pay. More on that in a minute—first, let's look at some risks in Instinet.

NEW RIVALS. While its revenues have been growing smartly, other trends are worrisome. The biggest is that annoying little thing called competition. Rivals have been multiplying with the new wave of "ECNs," or electronic communications networks, such as Island. In January, 2000, Instinet led this pack, handling 10.6% of volume in Nasdaq companies, more than the other ECNs combined. A year later, Instinet's share had grown to 12.2%, but its ECN rivals claimed 15.5%.

All of this had the usual ugly effect on prices and profits. Instinet's average revenue on each trade last year sank 19%. Its average pretax profit fell even faster, by 38%. It threatens to get

worse as Nasdaq prepares next year's launch of its own revamped trading system, "SuperMarket." Instinet CEO Douglas Atkin is keeping quiet ahead of the IPO, but the company's securities filing says: "We believe that the downward pressure on prices will continue."

So why am I not a stone bear? Instinet survived such threats before, notably in 1991 with the end of fixed brokerage commissions. My bet is it will survive again—and thrive. It boasts a long list of blue-chip clients. It's financially strong. It's growing in multiple ways abroad and via such new services as bond trading. It also has hedged itself with small stakes in Archipelago and Nasdaq, and owns about 8% of that unusual new underwriter, W.R. Hambrecht & Co.



TRADING FLOOR: Live from Instinet

Instinet's Vital Signs

	MILLIONS*	PERCENT CHANGE**
REVENUES	\$1,435	48%
PRETAX INCOME	265	13
NET INCOME	148	9
CASH FLOW	147	-41
INDICATED MARKET VALUE	2,955	-

* Operating results for 2000 ** From 1999
Data: Company reports

Because of that tie, up to 17.5% of the IPO shares will be sold via Hambrecht & Co.'s "OpenIPO" online auction. In a typical IPO, underwriters give their biggest clients the first dibs on shares and a large say in the offering price. Little investors get scraps. In Hambrecht's auctions—data available at www.wrhambrecht.com—anyone with \$2,000 to open an account can bid for shares equally. The higher you bid, the more

shares you will get them. Yet you also can bid low. Instinet's estimated IPO price is 20 times last year's earnings. That's no wild e-multiple; neither is it a bargain. Suppose, though, that you decide it's worth 14 times earnings, or \$9 a share. Through OpenIPO, you have the power to bid \$9. If the price ends up being priced below your bid at, say, \$7, you pay \$7. The risk you take is that the deal is priced higher and you get no stock. As an IPO goes, that's one worth running.

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In the New Economy, every business wants to be an e-business. And it's no wonder. New technologies offer enhanced speed, efficiency, and capabilities; new e-models promise to outmaneuver the old through a potent cocktail of innovation and agility. A business that can successfully digitize thus enjoys a huge competitive advantage, while one that cannot falls behind—and may even fall by the wayside. E-transformation, therefore, is not just desirable. It is essential.

The CFO plays an integral role in the transformation process. No longer just a numbers cruncher, today's CFO must aid in assessing, selecting, and implementing technologies; developing strategic partnerships; redesigning business models; and creating a corporate culture of change. In short, he or she must abandon the role of e.biz enabler and become, instead, an e.biz architect.

This concept was the topic of BusinessWeek's CFO as e.biz Architect forum, held February 28 through March 2 in Palm Beach, Florida. Conference highlights follow.

New Economy Business Models

Not long ago, everyone knew which business models worked. Today, these "truths" are in question thanks to e-enablement, which has spawned a dizzying array of new models. Some of these models represent the wave of the future. But which ones? An audience poll attested to the difficulty of picking a



winner. Only 6% were completely happy with their e-business model, while more than half had experienced some degree of failure.

Some models are clearly doing better than others. Amazon.com, for instance, is generating impressive revenue

(though no profits just yet) with its pioneering e-tailing model. **Warren Jensen**, Amazon's senior vice president and CFO, explains the advantages of the virtual storefront: "We've replaced real estate with technology. Ultimately this gives us lower invested capital, and at the same time the potential for higher returns. Over the long term, we believe that this trade will create continuing cost leverage."

It sounds logical. But there are practical problems with e-sales, says **James Parke**, vice chairman and CFO of GE Capital. "Right now, a lot of companies and consumers don't have the infrastructure to buy and sell online. So e-selling for us is still elusive." He is optimistic about the model's future, however: "I believe that e-sell will be the way in which we transact business going forward. It's just a matter of time."

When that time comes, dynamic pricing, which allows the price of a product or service to fluctuate with demand, buyer profiles, and other factors, may be part of the new business model. Proponents point to concrete advantages: "With dynamic pricing, the market finds its own level. Allow the market to set the value of one product, then use that information to inform the

Power to the People

It's popular right now for businesses to talk about employee empowerment, decentralization, and other techniques that spread responsibility among an ever-growing number of people and organizations. According to **Thomas Malone**, Patrick J. McGovern professor of information systems at MIT's Sloan School of Management, this talk is more than just a fad. It's a response to fundamental changes in the economics of communication and decision making.

How so? "As communication gets cheaper and cheaper, it becomes possible for the first time in history to let thousands or even millions of people have access to all the information that's relevant to making whatever decisions they need to make," Malone says. The result is informed, empowered employees—a good thing, says Malone, "because people who are making their own decisions are more creative, motivated, and innovative. So in the knowledge-based economy of the future, where creativity and innovation are often the keys to success, I think that letting more and more people have the information and the authority to make their own decisions may be the best thing we can do economically."

Tom Malone, the Patrick J. McGovern professor of information systems at MIT's Sloan School, opens the conference with a provocative talk on new economy business models and partnerships.



Scott Shuster (left), conference chairman, welcomes working group leaders—**Chet Burchett**, president and CEO of Burson-Marsteller U.S.A., **Roger Fisher**, director of the Harvard Negotiation Project and Samuel Williston professor of law emeritus at Harvard, and **Peter Pekár, Jr.**, national director of Houlihan Lokey Howard & Zukin's corporate alliances division—to the panel for the closing session.



rest of your pricing. It allows you to get to a value-based system," says eBay senior vice president of strategic planning and development, **Gary Bengier**.

Proper valuation is undeniably important in an increasingly transparent business world. CFOs seem to recognize this; an audience poll revealed that 70% of attendees had either adopted dynamic pricing or intended to do so. But some people, including **Ray Arthur**, CFO and senior vice president of Toysrus.com, fear a flip side. "It would be incredibly difficult for a bricks-and-mortar store manager to explain to a customer why an item that sells for \$9.99 on the Internet costs \$14 in the store. There's a customer trust issue, and we believe there would be a public backlash," he says.

Arthur's caution is understandable. New e-business models are uncharted territory where risk is concerned. As **Thomas Kaiser**, member of the group management board of Zurich Financial Services Group and CEO of Zurich Corporate Solutions, points out, "We are at the beginning of the development of e-business. Therefore, we have only scratched the surface of the e-business risks that will threaten our organizations in the future." Not understanding the risks, though, doesn't mean that one should back off: "Where there is risk, there is often reward in the form of opportunity and competitive advantage."

Technology Changes Everything

The advantages created by new technologies and e-enablement are indeed abundant. Consider the ease of real performance metrics, which offer on-demand snapshots of a business's vitals. Having this capability "will increase your ability to make proactive decisions concerning strategies, planning, and forecasts. It will increase your ability to identify problems and opportunities for advance. And that in turn will yield productivity gains," explains **Gene Kalw**, principal and consulting actuary with Milliman & Robertson, Inc.

Real-time metrics reporting may be today's hot topic. But it is just the latest in a decade-long string of technologies that have moved the CFO to the center of strategy formulation. Sure, a good idea—but what if your company is still trying to implement last year's innovation? The integration process can be time-consuming and expensive, and many companies are reluctant to commit resources to a new project before completing the old one.

Some companies are addressing this problem by providing easy-access Internet-based services that don't touch an organization's legacy systems. **Jeff Henley**, executive vice president and CFO of Oracle Corporation, describes the appeal of these services: "You just link to a Website and use them. The

CFO 2001

"The CFO is the individual best placed to understand the demands on an organization from all sides." —**THOMAS KAISER**, member of the group management board, Zurich Financial Services Group and CEO, Zurich Corporate Solutions



egration challenge, and that's what makes them so attractive." Just because management likes it, though, doesn't mean employees will use it: "The challenge is getting the adoption," admits Henley. Endorsers such as GetThere that offer on-based corporate travel booking are tackling this challenge by going inward. "We are continually finding ways to demonstrate real savings on our product, which we believe will convince people that it needs to be adopted. The transition is a change that has to flow throughout the company's culture," says **Jeffrey Jackson**, executive vice president, and treasurer of Sabre, GetThere's parent company.

It's not that change is easier said than done, especially in old-line companies with established corporate cultures. "This company has done stuff for a long time successfully, and now we want our products to change dramatically. And that's not easy," comments **Robert Brust**, executive vice president and CFO of the 120-year-old Eastman Kodak Company. "In fact, we found that changing the culture is the hardest part. I have to be in there pushing the time, making sure that people are doing stuff they don't want to do."

Keeping the Assets Happy

Henley's experience is not unique. Most executives acknowledge that making change is difficult for employees. Yet change is one of the few constants of the New Economy. Is it possible to keep employees happy while meeting corporate goals?

SAS thinks so. SAS's employee-care program includes a generous benefits package, on-site daycare and health care, gymnasiums, cafes, private offices, and more. As a result, SAS's turnover is about 4% compared to the typical industry figure of 10%. There are bottom-line benefits to the company's generosity: "Between lost productivity, recruiting, moving a new employee, paying a starting bonus, and increasing the cost of one person leaving



After hearing his inspirational dinner keynote address, conference participants surround **Lou Holtz**, head football coach at the University of South Carolina, seeking autographs.

the company can easily equal a year's salary," says **James Goodnight**, SAS's CEO. Therefore, reduced turnover has an actual dollars-and-cents value. But the intangible costs may be equally important. "Our employees feel like the company cares for them, so they treat our customers like they really care. And that makes the customers feel good about us."

Businesses are also discovering that employees are happiest when they feel that they are pulling together toward common goals—and there is an increasing recognition that finance professionals must participate in that effort rather than just enforce the rules. As **Roger George**, CFO, vice president, and general counsel for SkyStream Networks, puts it, "We try to resist the temptation to see the finance group as the adult supervision in the company. Instead, we take a collaborative approach. We're part of the team."

Playing on the team necessitates an increased emphasis on personal relationships, which may be new ground for CFOs accustomed to dealing mostly with facts and figures. **Roger Fisher**, director of the Harvard Negotiation Project and Samuel Williston professor of law emeritus

No Pain, No Gain

Like most international companies, Oracle Corporation has accepted the need for a single global database and uniform global business processes. Accordingly, an ambitious change process is underway: "Within about three years, we're going to change every business system in the company to go to a global single instance," says **Jeffrey Henley**, Oracle's executive vice president and CFO.

So what's the hardest part of the process? According to Henley, it's convincing people to change. "Especially in the initial stages, there was tremendous resistance. I don't think most people actually believed that what we set out to do was possible. We're further down the road now and there's less resistance, but I'd be lying if I said we weren't still fighting daily battles."

Henley is convinced that the results will be worth the pain. But he offers this advice to anyone thinking about following Oracle's lead: "Aim high. Start with a big vision and a big financial target. This is a tough process to go through, so you'd better have big numbers in mind. Otherwise it's not worth doing."

Jeff Henley, Oracle's executive vice president and CFO, responds to a question from the audience after his talk on driving e-business shareholder value.



BY INDUSTRY: E-NORMOUS TRANSFORMATION?

Enormous changes wrought by e-business and new IT-based techniques.	11%
Some changes, but not big ones -- yet. They are coming.	64%
Some changes seen but few more anticipated.	25%
Industry not much changed by e-business/IT innovations.	0%

Interactive polling provided courtesy of **MERIDIA** Audience Response Service, Plymouth Meeting, PA

"There are great risks to building a virtual-close capability. You have to have a culture that accepts change and a leadership that promotes it."

GENE KALWARSKI, FSA, principal, and consulting actuary, Milliman & Robertson, Inc.



"By digitizing a flawed process, all you do is make that flawed process go faster."

JAMES PARKE, vice chairman and CFO, GE Capital

"One of our great things is our culture, and one of our big problems is our culture. After 100 years of success, the resistance to change is cemented."

ROBERT BRUST, executive vice president and CFO, Eastman Kodak Company



"Traditionally, pricing has been static. The fundamental change is to embrace pricing as something dynamic."

GARY BENGIER, CFO, eBay, Inc.

"More and more companies are becoming Web. They don't want to use products that are not self-ser-

JEFFERY JACKS, executive vice president, CFO, and treasurer, Sabre



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at Harvard University, underscores this new reality: "Your job description doesn't tell you to pay attention to nonfinancial issues. But remember that you're not only dealing with money and numbers. You're also dealing with human beings."

And the most important thing a CFO can give those human beings is strong leadership, says **Lou Holtz**, head football coach at the University of South Carolina. "Your employees are looking to you for leadership. The more difficult the situation, the stronger and the more positive your leadership has to be. An experience can be either wonderful or miserable, depending on your attitude. It's a choice, and it starts with you."

Today's CFO

A positive, forward-thinking attitude is, in fact, critical to the role of the modern CFO, says **Chet Burchett**, president and CEO of Burson-Marsteller U.S.A. "Today's CFO has to be willing to be a transformational leader as opposed to a transactional manager," he says. And while Burchett acknowledges that this role may be a step outside the comfort zone, he argues that it is the CFO's duty to take it on. "There is a bottom-line value for the

company. It is part of the fiduciary responsibility of the CFO to support success of the company by behaving ways that sometimes are not comfort

Peter Pekár, Jr., national director of Houlihan Lokey Howard & Zukin's corporate alliances division, believes that responsibility goes even deeper. It is enough, he says, for CFOs to communicate internally. They must communicate with other CFOs as well. Why? "An estimated one-third of the revenue generated in the next five years will come from collaboration. But Wall Street doesn't know how to analyze this. It can't put value on corporate alliances," says Pekár. "It therefore behooves CFOs to come together and talk about these issues. How do we measure alliances and how do we educate Wall Street to see us clearly?"

It's an ambitious plan with clear benefits. But realistic? Perhaps not just yet. The metrics are still fuzzy, and the challenges of e.biz transformation will keep most CFOs busy for years to come. But new models and technology born of the transformation will provide as-yet-undreamed-of tools to the CFO of tomorrow. E.biz architect today, sculptor of the world's financial markets tomorrow. Only time will tell.

BusinessWeek

|Events|

LUMPED-UP FURNITURE?



GENE G. MARCIAL

Something odd is happening at Furniture Brands International (FBN), the largest U.S. maker of such ware: It posted worse-than-expected first-quarter results, with sales falling 10.2% from a year ago and earnings per share tumbling 36%. Yet most analysts continue to rate the stock a buy—if not a strong buy. The stock has been a winner, running up from 15 a share in mid-November to 26 by February before settling back at 24.20 on May 2.

What's going on? "For starters, it's a Warren Buffett type of stock," says Bob Olstein of Olstein Financial Alert Fund. In fact, Buffett's Berkshire Hathaway took a 1.5% stake late last year. Evidently Buffett sees the same values we do in the company," says Olstein, who says the stock is worth 35. Trading at a depressed price-earnings ratio of 11, FBN is in a good business with strong cash flow, and is now poised for a turnaround, he says. Olstein's specialty is looking behind the numbers to spot value and avoid risks. His fund has racked up a 15.3% gain this year—as of May 2.

New management came in three years ago, and earnings stood flat while it tried to reposition the company for growth—which Olstein expects will pay off by next year. He sees earnings per share perking up, to \$2.15 a share in 2002 and to \$3 in 2003, vs. an estimated \$1.80 in 2001. Olstein says FBN is generating cash flow of \$70 million this year, which could hit \$100 million by 2003.

Analyst Cody McGarraugh at investment firm Stifel Nicolaus says FBN's licensing pact with Home Depot will be a plus. Home Depot will pay royalty fees for the use of FBN's Thomasville brand. Its stores will be selling furniture that it will outsource with the Thomasville name. McGarraugh expects royalty payments of some \$4 million in the first year of the pact.

JONES APPAREL STEPS OUT IN STYLE

Jones Apparel Group (JNY) is marching to a different drummer—and it's headed upward. While most other apparel and retailing stocks have been flattened by the fierce downturn, Jones has zipped from 27 in December to 42.97 five months later. One reason: Jones had a bang-up Christmas, with record fourth-quarter sales and earnings. And first quarter, 2001, was also upbeat: Earnings of 75¢ a share beat Street expectations of 71

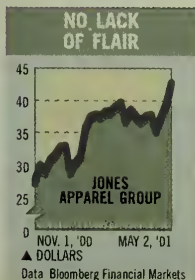
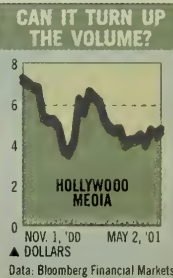
cents. Jennifer Black of Wells Fargo Van Kasper says Jones's vast rack of brands, including Nine West, Evan-Picone, and Lauren by Polo Ralph Lauren, lets it grab market share.

Black, who rates Jones a "strong buy," thinks the runup is far from over: Her 12-month price target is 55, or 16 times her 2002 estimated earnings of \$3.44 a share. For 2001, Black sees Jones earning \$3. Jones's success in adding brands has been mainly through acquisitions. Its latest buy—for \$572 million—was the McNaughton Apparel Group, which should immediately boost earnings. Black figures it will add 5¢ to 6¢ a share to next year's bottom line.

Black expects Jones's acquisition mode will continue after digesting the McNaughton deal. And she expects Jones will continue to surprise the Street "and pull rabbits out of its hat."

AOL DISCOVERS HOLLYWOOD MEDIA

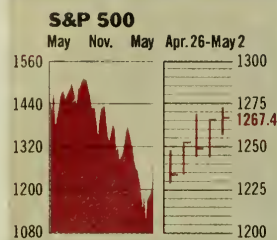
The business of Hollywood Media (HOLL) is not film-making. Instead, it supplies data on movies and Broadway shows to media and the Internet. It also markets tickets over the Web. It has attracted support from big media and financial companies—including Viacom, which owns 30% of its stock; J.P. Morgan Chase, which owns 10.3%; and Tribune Co., with 10%. The latest to join: AOL Time Warner, whose MovieFone unit formed an alliance with MovieTickets.com, which is 29% owned by Hollywood Media. This new venture creates a nationwide network that will make it easier to buy movie tickets on the Web, according to Hollywood Media Chairman Mitch Rubenstein. AOL took a 3% stake in MovieTickets.com as part of the deal. All this bodes well for Hollywood Media, says Jan Loeb of investment bank Dresdner Kleinwort Wasserstein, who rates Hollywood Media a buy, with a 12-month price target of 17. AOL paid \$8.5 million, which implies a total value of \$280 million for Movietickets.com. So Hollywood's 29% stake in Movietickets.com comes to \$18 million, or about \$3.25 a share. With Hollywood stock trading at 4.85, investors in Hollywood are getting its business-to-business and business-to-consumer business, and all its intellectual property, at only \$1.75 a share, figures Loeb. He puts the value of the ticketing business at \$4.85 a share; B2B business at \$4.25; B2C business at \$5.05, and the remainder at \$2.45, or a total of nearly 17.



BusinessWeek online

Read Gene Marcial's Inside Wall Street Online column Tuesday afternoons at www.businessweek.com/today.htm. And see him Fridays at 1:10 p.m. EST on CNNfn.

Stocks



COMMENTARY

Can you say "rally"? Tech stocks propelled the Nasdaq to its highest level in two months. Bellwethers like Cisco and Intel led the Nasdaq charge, which rose 7.8% for the week. The Dow, up 2.4%, and S&P, up 3.1%, also fared well. The market was buoyed by talk of an economic turnaround as well as anticipation of another interest-rate cut by the Fed on May 15.

Data: Bloomberg Financial Markets
Bridge Information Systems, Inc.

U.S. MARKETS

	May 2	Week	% change Year to date	Last 12 months
S&P 500	1267.4	3.1	-4.0	-12.4
Dow Jones Industrials	10,876.7	2.4	0.8	1.4
Nasdaq Composite	2220.6	7.8	-10.1	-41.3
S&P MidCap 400	514.0	4.0	-0.5	8.0
S&P SmallCap 600	222.6	3.8	1.4	9.3
Wilshire 5000	11,700.2	3.7	-3.9	-13.1

SECTORS

	May 2	Week	% change Year to date	Last 12 months
BusinessWeek 50*	894.2	2.9	-7.8	-28.4
BusinessWeek Info Tech 100**	525.2	8.1	-7.2	-45.0
S&P/BARRA Growth	632.5	4.5	-8.0	-27.3
S&P/BARRA Value	635.1	2.0	-0.2	5.1
S&P Energy	920.5	-3.1	-1.2	7.5
S&P Financials	155.9	2.7	-5.3	17.7
S&P REIT	87.7	1.6	-0.3	8.5
S&P Transportation	716.7	3.6	2.7	22.8
S&P Utilities	333.7	-1.0	-4.8	27.3
GSTI Internet	154.7	14.2	-14.9	-67.4
PSE Technology	792.0	6.4	-2.7	-26.1

*Mar. 19, 1999 = 1000 **Feb. 7, 2000 = 1000

BEST-PERFORMING GROUPS

	Last month %	Last 12 months %
Entertainment	31.1	112.9
Semiconductors	30.8	108.4
Office Equip. & Supplies	30.5	76.9
Communications Equip.	27.3	75.5
Invest. Banking/Bkrge.	25.5	71.7

EQUITY FUND CATEGORIES

4-week total return	%	52-week total return	%
Leaders		Leaders	
Technology	37.3	Financial	27.6
Communications	28.5	Natural Resources	22.7
Small-cap Growth	23.4	Mid-cap Value	20.6
Mid-cap Growth	21.9	Small-cap Value	19.6
Laggards		Laggards	
Real Estate	3.9	Technology	-43.4
International Hybrid	4.8	Communications	-41.4
Financial	6.9	Japan	-32.6
Pacific/Asia ex-Japan	7.2	Diversified Pacific/Asia	-28.7

EQUITY FUNDS

4-week total return	%	52-week total return	%
Leaders		Leaders	
ProFunds UltraOTC Inv.	79.6	Schroder Cap. Micro Cap	90.7
Berkshire Focus	77.0	CGM Focus	79.6
Potomac Internet Plus	76.4	Potomac Internet Short	69.2
Berkshire Technology	75.5	State St. Res. Glob. Res. A	65.5
Laggards		Laggards	
ProFunds UltraShort OTC	-53.7	ProFunds UltraOTC Inv.	-82.6
Potomac Internet Short	-44.7	Jacob Internet	-77.4
Potomac OTC Short	-30.8	ING Internet A	-72.5
Rydex Arktos Investor	-30.1	Potomac Internet Plus	-72.4

Data: Standard & Poor's

GLOBAL MARKETS

	May 2	Week
S&P Euro Plus (U.S. Dollar)	1266.0	2.6
London (FT-SE 100)	5904.2	1.3
Paris (CAC 40)	5572.9	2.7
Frankfurt (DAX)	6213.8	1.5
Tokyo (NIKKEI 225)	14,421.6	4.9
Hong Kong (Hang Seng)	13,814.2	3.8
Toronto (TSE 300)	8018.4	0.9
Mexico City (IPC)	6109.2	3.8

FUNDAMENTALS

	May 1	Wk.
S&P 500 Dividend Yield	1.24%	1.3
S&P 500 P/E Ratio (Trailing 12 mos.)	28.5	26.
S&P 500 P/E Ratio (Next 12 mos.)*	22.2	21.
First Call Earnings Revision*	-4.53%	-4.3

*First Call Corp.

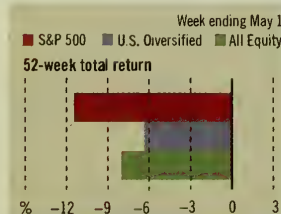
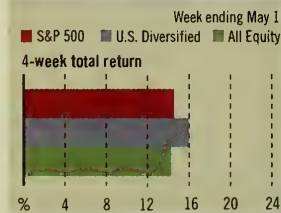
TECHNICAL INDICATORS

	May 1	Wk.
S&P 500 200-day average	1348.8	1355.0
Stocks above 200-day average	66.0%	58.0
Options: Put/call ratio	0.58	0.62
Insiders: Vickers Sell/buy ratio	2.74	2.90

WORST-PERFORMING GROUPS

	Last month %	Last 12 months %
Alcoholic Beverages	-13.7	Communications E
Savings & Loans	-7.1	Long-Dist. Telecom
Toys	-6.3	Metal & Glass Cont
Building Materials	-5.5	Semiconductors
Conglomerates	-5.4	Instrumentation

Mutual Funds



Data: Standard & Poor's

Interest Rates

KEY RATES

	May 2	Week ago
MONEY MARKET FUNDS	4.64%	4.73%
90-DAY TREASURY BILLS	3.88	3.84
1-YEAR TREASURY BILLS	3.89	3.85
10-YEAR TREASURY NOTES	5.29	5.28
30-YEAR TREASURY BONDS	5.70	5.78
30-YEAR FIXED MORTGAGE†	7.16	7.07

†BancQuote, Inc.

BLOOMBERG MUNI YIELD EQUIVALENTS

Taxable equivalent yields on AAA-rated, tax-exempt bonds, assuming a 31% federal tax rate.

	10-yr. bond
GENERAL OBLIGATIONS	4.51%
TAXABLE EQUIVALENT	6.54
INSURED REVENUE BONDS	4.62
TAXABLE EQUIVALENT	6.70

THE WEEK AHEAD

INSTALLMENT CREDIT Monday, May 7, 3 p.m. EDT ► Consumers likely took on an additional \$10 billion of debt in March. That's according to the median forecast of economists surveyed by Standard & Poor's MMS, a division of The McGraw-Hill Companies. In February, consumers added \$13.5 billion of debt, and credit as a percentage of disposable income grew from 21.7% to a record 21.8%.

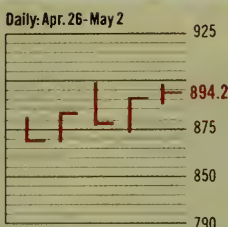
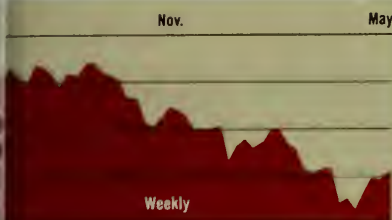
PRODUCTIVITY & COSTS Tuesday, May 8, 8:30 a.m. EDT ► Output per hour worked

in the first quarter likely grew at an annual rate of 1.4%. That follows a 2.2% rise in fourth-quarter productivity, calculated from a 0.8% rise in production and a 1.4% drop in hours worked. Unit labor costs probably rose about 3%, after rising 4.3% in the fourth quarter.

EXPORT-IMPORT PRICES Thursday, May 10, 8:30 a.m. EDT ► Export prices in April were probably unchanged, after dipping 0.1% in March. April import prices likely rose 0.2%, after falling 1.6%.

RETAIL SALES Friday, May 11, 8:30 a.m. EDT ► Retail sales probably rose in April, after falling 0.2% in March. Retail sales, excluding vehicles, sales likely rose by 0.4%, after falling 0.1% in March.

PRODUCER PRICE INDEX Friday, May 8, 8:30 a.m. EDT ► Producer prices for finished goods likely rose just 0.2% in April. Core prices, which exclude food and energy, likely advanced by 0.1% in March, prices fell by 0.1%, while prices increased 0.1%.

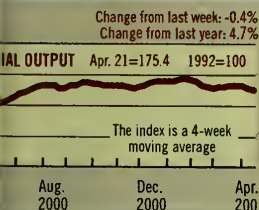


le the coattails of a Nasdaq rally this week. The index posted a 2.9% gain, largely due to sev-
locks such as Sun Microsystems, which rose 27.4% on bullish analyst reports, and Tellabs, which
The biggest losers were energy companies Apache and EOG Resources, down 11.2% and 11.0%,
hich were hurt by reports of rising U.S. oil and gas inventories.

COMPANY PERFORMANCE

Company	% change		Rank	Company	% change	
	Week	Since 3/1/01			Week	Since 3/1/01
National	0.9	-3.9	26	Verizon Communications	3.1	17.5
Petroleum	-9.8	-5.1	27	Alza	3.7	20.8
	4.4	25.6	28	Citigroup	2.6	4.0
	-1.1	19.2	29	Sun Microsystems	27.4	1.9
Materials	2.8	20.7	30	Merck	0.1	-6.1
Financial	7.4	9.0	31	El Paso	-4.8	-7.1
Oil Petroleum	-5.6	17.6	32	Altera	6.9	8.3
	-11.2	-2.2	33	Marsh & McLennan	8.1	-6.0
Health	-6.8	4.6	34	Household International	1.1	12.1
	-0.5	-19.7	35	Chevron	-3.5	5.9
Procter & Gamble	7.2	13.3	36	SBC Communications	3.9	-6.9
	15.1	2.5	37	Mercury Interactive	16.9	19.7
	0.6	-11.6	38	AOL Time Warner	4.3	17.3
Laboratories	5.6	-9.4	39	Washington Mutual	-2.2	-1.8
Bank of America	3.2	-3.9	40	General Dynamics	8.5	17.6
Technology	1.0	20.1	41	Comcast	5.3	3.0
	4.6	16.3	42	Morgan Stanley Dean Witter	8.3	4.6
Hess	-4.4	13.6	43	Tellabs	24.9	-8.5
Energy	-2.1	8.3	44	Exxon Mobil	-2.9	6.3
Communications	8.9	-26.1	45	Scientific-Atlanta	8.2	32.3
Bank of America	4.0	15.5	46	U.S. Bancorp	-0.3	-8.3
Petroleum	-5.4	5.9	47	Paychex	-10.9	-17.5
Services	12.2	22.3	48	Merrill Lynch	6.8	11.7
Resources	-11.0	-2.7	49	Bed Bath & Beyond	-2.6	11.7
Health	0.7	0.8	50	Texas Instruments	14.0	23.3

Production Index



in index fell in the latest week. Before
e four-week moving average, the index
ally unchanged at 174.1, from 174. After
tments, steel, electric power, and lumber
Autos, trucks, coal, and rail-freight traf-
crude-oil refining was nearly unchanged.
puter error, the index has been revised
January, 2001. To request the new data,
business_outlook@businessweek.com
ch of the index components is at www.businessweek.com
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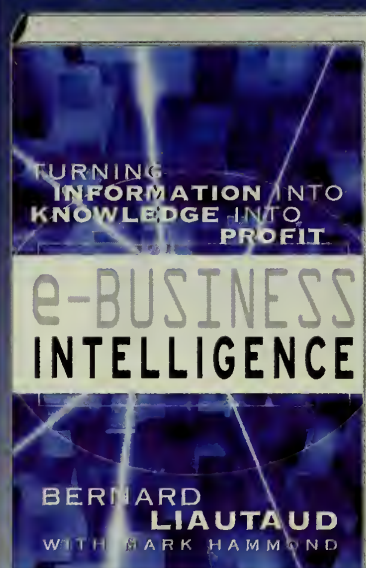
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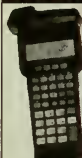
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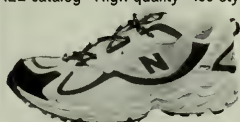
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BusinessWeek (ISSN 0007-7135) published weekly, except for one week in January and August, by The McGraw-Hill Companies, Inc. Executive, Editorial, Circulation, and Advertising (1221 Avenue of the Americas, New York, N.Y. 10020, U.S. subscriber rate \$54.95/year, Canada \$69/year. Periodicals postage paid at New York, N.Y., and at additional mailing offices. Postmaster: Send address changes to BusinessWeek, P.O. Box 430, Hightstown, N.J. 08520.

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TIME TO CUT THE ACCOUNTING SHENANIGANS

Where's the outrage? Companies report "pro forma" earnings that are deceptive, unwarranted, and downright dangerous to the financial system—and no one complains. During the boom, chief executives pumped up earnings by casting aside any constraints on how and when they booked sales and calculated costs. And people turned a blind eye to accounting shenanigans as long as stocks moved ever higher. Then came the bust, and corporations played the same numbers game to soften the blow to earnings, hoping again for investors' complicity. But this time, the market is showing signs of punishing companies playing the numbers game. CEOs should recognize this switch in investor sentiment and jettison anything-goes accounting quickly. It's time to get back to generally accepted accounting principles (GAAP), which have the virtue of transparency, comparability, and a decent dose of honesty.

Some gaming of earnings has been around for a long time. A small number of companies have always played around the edges of Securities & Exchange Commission standards. But now nearly all companies stretch GAAP standards to make up their own. The latest wave of "creative accounting" began in the 1980s with the rise of EBITDA—earnings before interest,

taxes, depreciation, and amortization—an early form of pro forma accounting. By the 1990s, pro forma had been stretched to include virtually any gimmick by earnings-deficient companies—especially in high tech. With pro forma accounting, companies just make up the numbers, including what they want, excluding what they don't (page 100). Yahoo! Inc., for instance, excludes the cost of buying Internet companies and of payroll taxes on stock options. Exodus Communications Inc. excludes some acquisition costs but not options taxes. Zon.com Inc. simply excluded from its first-quarter pro forma operating losses a net interest expense of \$24 million and a \$114 million charge for restructuring.

This anything-goes accounting must end. It is becoming impossible to compare price-earnings ratios because companies define their earnings in so many different ways. Stock indexes are increasingly suspect. Investors are at sea. Companies still must publish true figures according to GAAP, but they are usually hidden somewhere in quarterly reports, often in obscure footnotes. News releases and analyst programs tout pro forma "headline" numbers. The market is beginning to express outrage at this abuse. Wise investors should take note.

MISSILE DEFENSE: A TRICKY COURSE

President Bush succeeded in getting his proposal for a missile defense system off to a good start. He presented his radical shift in national security policy within a framework of multilateral consultation with allies and promised negotiations with Russia and China. He linked missile defense to a sharp cutback in the number of strategic nuclear warheads held by the U.S. and Russia. And he articulated the goal for missile defense correctly as serving to "strengthen global security and stability."

But the stakes are enormously high in changing security policy at this time. The Bush plan would breach the 1972 Anti-Ballistic Missile Treaty, a cornerstone of U.S.-Russia relations. The new system would begin to be deployed well before any of the technologies behind the land, sea, and air-based anti-missile weapons are fully tested. And it could antagonize far more friends and allies than the handful of rogue states it targets. Indeed, ballistic missiles may not be the worst threat from Iraq, Libya, or North Korea. Suitcase nukes or biological weapons carried into U.S. cities may pose more danger (page 62).

Europe has expressed great skepticism about any kind of Star Wars-type defense shield, arguing that it could trigger another arms race. And Russia has denounced any unilateral abrogation of the ABM Treaty. The greatest danger may come from China which could feel the most threatened by a U.S. missile shield, especially a sea-based, forward system that sits

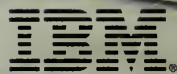
off its shore. China only has about 20 Sixties-era ballistic missiles, each carrying a single warhead. Russia and the United States have hundreds of missiles carrying thousands of warheads. China could respond by building a large, modern ballistic missile force. That, in turn, could set off a nuclear arms race that includes India, Pakistan, perhaps even Japan, and could destabilize the entire Pacific region.

Unless properly negotiated, a U.S. missile-defense system would also strengthen the hand of the military and political hard-liners in China at a time of transition. China is about to enter the World Trade Organization, and it is opening its economy wide to global investment. One-party authoritarianships in South Korea and Taiwan eventually evolved into market democracies. China could take that route—or remain authoritarian. No one yet knows, but relations with the United States will undoubtedly play a role.

President Bush called Russian Premier Vladimir Putin before announcing his plan, inviting him to work together on anti-missile defense. That is the correct approach. If he negotiates a deal with Russia to join in missile defense, he will get the Europeans to agree to the plan. And that would be a long way toward enhancing the safety and security of the world. But Bush did not make a similar call to Chinese Prime Minister Jiang Zemin. If his missile defense plan makes new enemies and generates nuclear turmoil in Asia, it will not succeed despite the President's good intentions.

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Who Can Charge
On the Web,
Who Can't



The e.biz 25

The Most Influential People
In Electronic Business

07. How should you implement an e-business infrastructure?

- (a) *deploy, debug, strategize*
- (b) *install, deploy, retrofit*
- (c) *strategize, test, deploy*
- (d) *panic, spend, weep*

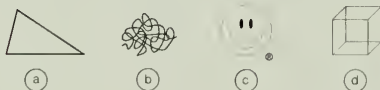
08. What does it take to maintain a secure infrastructure?

- (a) *universal password protection*
- (b) *test your own system for vulnerabilities*
- (c) *build a redundant security that frustrates hackers*
- (d) *all of the above*

09. The most important action when merging two different companies' IT systems is:

- (a) *a pep rally*
- (b) *celebrate the merger with a commercial*
- (c) *expensive and tedious "workarounds"*
- (d) *adopt open standards*

10. Which of the following best represents a well-implemented infrastructure?



11. Infrastructure is to profit as:

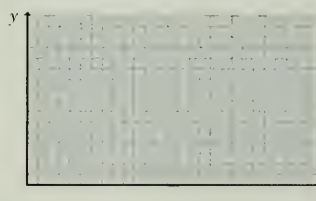
- (a) *speed is to wireless*
- (b) *customer is to sale*
- (c) *capacity is to servers*
- (d) *all of the above*

12. Venture capital is most likely attracted to start-ups with:

- (a) *the best logo*
- (b) *those who have failed before*
- (c) *MBAs who wear sandals*
- (d) *business plans that take into account 1 billion mobile users worldwide*

13. Complete this graph:

x equals the amount of abandoned online shopping carts
y equals the delays attributed to an online store's sluggish servers



14. The most complex infrastructure challenge for mobile e-business is:

- (a) *reducing Web page sizes for PDAs*
- (b) *responding to a billion wireless devices*
- (c) *reconciling 30 different platforms, including Bluetooth, WAP and Palm*
- (d) *all of the above*

15. How do you know you're ready for IBM?

- (a) *they're having a sale*
- (b) *you overheard people talking about them at a business dinner*
- (c) *you realize infrastructure is the biggest and single most important issue of this decade*
- (d) *you need a supercomputer to defeat a chess master*

THIS WAS ONLY A POP QUIZ. The real test is extremely difficult. And you may not have a lot of time. That's why you need to know as much as you can about e-business infrastructure now. It's complicated, complex and a hard concept to grasp. If you don't understand it fully, you want a partner who does. Someone like IBM that has the knowledge, resources and experience of having built solid infrastructures in your industry. Call 800 426 7080 (ask for infrastructure) or head to **ibm.com/e-business**



THE NATIONAL E-BUSINESS INFRASTRUCTURE

Pop Quiz

01. What is an e-business infrastructure?

- (a) *I don't know*
- (b) *the foundation for a closed enterprise*
- (c) *the inside structure of four walls*
- (d) *intranets, extranets, servers, storage, software; everything that connects employees to customers to suppliers to partners*

02. A well-thought-out infrastructure is necessary for...

- (a) *handling 2 billion transactions a minute*
- (b) *instant collaboration*
- (c) *designing, building, launching and delivering a new model of automobile*
- (d) *all of the above*



03. What scenario best describes this photo?

- (a) *forgot to order mineral water*
- (b) *mispronounced German client's last name*
- (c) *made the evening news...in a bad way*
- (d) *learned that his infrastructure could not scale to meet new customer demands*

04. A shipment of steel alloy is traveling 100 miles to point X at 75 mph. A shipment of plastics is traveling 86 miles to point X at 65 mph. Which will arrive first?

- (a) *the one pulled by the newest locomotive*
- (b) *the one with the lightest load*
- (c) *they both arrive at the same time because they were connected to the same reliable back-end infrastructure*

05. Complete this sentence in the pluperfect:

Our infrastructure failed because _____ integrating multiple platforms and protocols.

- (a) *we're having trouble*
- (b) *we have had trouble*
- (c) *we have trouble*
- (d) *we had had trouble*

06. A well-planned e-business infrastructure helps supply chains...

- (a) *count presidential ballots*
- (b) *stock Mt. Everest base camps*
- (c) *plan festive holiday parties*
- (d) *replenish inventories on demand*

Answers

01. d 02. d 03. d 04. c 05. b 06. d

FEATURED

(LEFT TO RIGHT) **Stuart Wolff**, Homestore.com; **Rick Belluzzo**, Microsoft (seated); **Monica Luechtefeld**, Office Depot; **Jeff Bezos**, Amazon.com; **Pradeep Sindhu**, Juniper Networks; **Paul Bourke**, Altra Energy Technologies; **Lawrence Lessig**, Stanford Univ.; **Hal Varian**, Univ. of CA. at Berkeley (seated); **Bill Coleman**, BEA Systems; **Ray Ozzie**, Groove Networks

ALSO ON THE LIST

Pekka Ala-Pietila, Nokia; **Tony Ball**, BskyB; **Steve Case**, AOL Time Warner; **Michael Dell**, Dell Computer; **Scott McNealy**, Sun Microsystems; **Courtney Love**, Hole; **Thomas Middelhoff**, Bertelsmann; **Takeshi Natsuno**, NTT DoCoMo's i-mode; **Michael Powell**, FCC; **Gary Reiner**, GE; **Steve Sanger**, General Mills; **Jeffrey Skilling**, Enron; **Masayoshi Son**, Softbank; **Meg Whitman**, eBay; **Martin Wygod**, WebMD



e.biz

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home page

Get Yourself A Dot-Com Mansion

Like New Yorkers who comb obituaries for apartment leads, real estate agents are reading between the tech-slump headlines to hunt for hungry sellers. Consider Austin (Tex.) realtor Roxann Coffman. Last year, she had a client—Dell Computer Co-President James T. Vanderslice, an IBM transplant from New York—but no house fit for a tech titan. She did, however, have a newspaper.

So Coffman called Donald Hackett, then the CEO of drkoop.com Inc., and asked if he would sell his posh digs. The beleaguered dot-commer had wanted to sell for a while. Hackett says the home, which sold for \$4.5 million, was an investment anyway. Since its appraised value was \$2.8 million, Hackett made money. And he is starting up MyDNA.com Corp. to boot. Too bad drkoop stock didn't do as well.

—Andrew Park



BIG BLUE (COLLAR, THAT IS) ONLINE

The Internet is still making inroads into the masses. The biggest gain in home Web access in the past year has been the 52% jump among blue-collar workers—twice the rate the home Web audience in the U.S. has grown since Web stocks began wobbling in March, 2000.

Online 3/2000 (millions)	Online Now (millions)	% Change
Factory Operator/Laborer		
6.2	9.5	52%
Homemaker		
1.6	2.4	49%
Retired		
6.6	8.5	28%
Self-Employed		
7.4	9.2	24%
Executive/Management		
11.9	14.4	21%

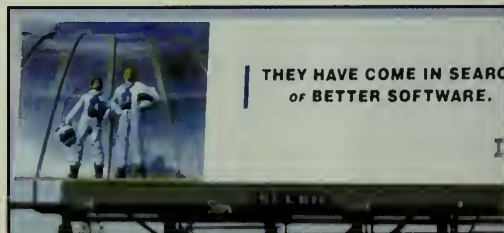
Data: Nielsen/Net Ratings survey

Billboard Battles

Oracle Corp. is shocked, shocked. Oracle marketing chief Mark Jarvis is driving to work in March, and right next to Oracle's Silicon Valley campus he discovers...this! IBM has put up a billboard with pseudo-astronauts announcing, "They Have Come in Search of Better Software: IBM." Oracle CEO Lawrence J. Ellison has been down this road before, and within 48 hours, Oracle's freeway-side riposte is right next to IBM's jab: "If you've come in search of better software, you've come to the right place...Oracle."

IBM's \$500,000-a-year ad is part of a campaign to close the one-percentage-point market-share gap between Big Blue and Big Larry in database software. Surprise, the billboard trick is true IBM: not quite

original enough to be hip. In 1997, rival Informix Corp. put a now-legendary sign outside Oracle featuring a samurai sword—a sly reference to Informix' "datablade" technology and Ellison's love of Japanese cul-



ture. Within a year, Oracle poached Informix' key programmers, making the company an also-ran until Apr. 24, when IBM paid \$1 billion to buy its database unit.

IBM spokesman Joe Stunkard isn't scared. "We're a rather confident bunch," he says. But Eastern wisdom says: Be careful when you tick off Silicon Valley's richest man.

—Jim Kerstetter



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BY ROGER O. CROCKETT

roger_crockett@ebiz.businessweek.com

The Net: A Loser on Race

Tech is harming itself by not putting enough minorities in the executive suite

Remember how the Internet was supposed to change everything? As it turns out, there's at least one thing it hasn't changed at all: the racial complexion of America's tech industry. During four years of covering the Net for *BusinessWeek*, I've sat down with more than a score of top-tier CEOs. Remarkably, just a handful have been black or Hispanic. And at tech conventions such as Comdex, or at

analysts' meetings on Wall Street, precious few attendees look like me. "You'd think that people in technology would be more forward-thinking," laments Cheryl E. Mayberry, a black tech veteran from Chicago who founded NiaOnline, a Web site for black women. "But it's not happening."

It sure isn't. When it comes to promoting women and people of color to the upper ranks, Net companies have crept along slower than crippled crawdads. For the past three years, *e.biz* has identified the 25 most influential people in e-commerce. Our inaugural list showcased 19 white men, four white women, one Asian-American man, and one Japanese man. Not one was African American or Hispanic. This year the list includes just one African American, two women, and two Japanese. Hispanics were shut out again.

Lest you think the diversity dearth is a deficiency of *e.biz*, be assured that we searched worldwide for women and people of color who might qualify as e-commerce elite. But here's the reality: Few minorities and women have emerged as leaders at the Net's most powerful organizations. "There's an established network in the dot-com world that makes it harder for people outside that network to break in," says Elsa Macias, director of information technology research at the Tomás Rivera Policy Institute, a Claremont (Calif.) think tank.

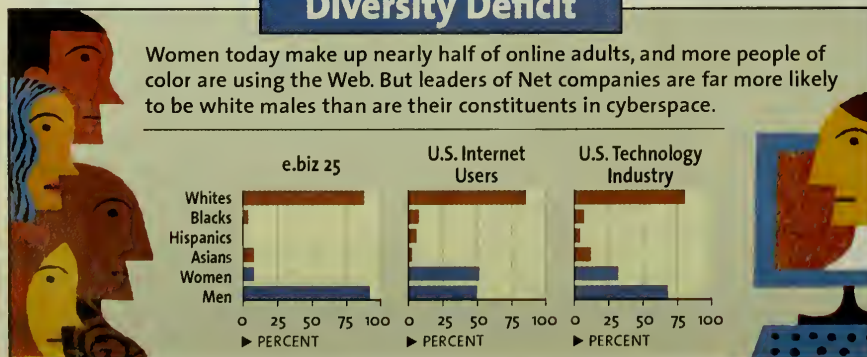
In fact, tech companies are worse than the norm. Women account for just 9.8% of officers at 56 top U.S. tech companies, according to researcher Catalyst. Yet they represent 12.5% of officers at the nation's 500 largest enterprises. In 1998, just 2.4% of the managers in Silicon Valley's tech industry were black and only 3.3% were Hispanic, says the Coalition for Fair Employment in Silicon Valley, an industry watchdog. More recent data are unavailable, but whatever smidgen of progress has been made is "a little late and a little slow," the Rev. Jesse Jackson told me recently.

Why does diversity matter? Forget for a moment issues of social justice. Think economics. The ethnic makeup of the U.S. consumer base is changing. Latinos have surged to 12.5% of the population from 10.3% a decade ago—nearly on par with blacks, at 12.9%. Black and Hispanic households with Net access are closing in on the 45% of white households online, according to Forrester Research. And let's not forget that we're talking about the *Worldwide Web* here. While 57% of Net users reside outside of North America, 20 of this year's *e.biz* 25 live in the U.S.

Companies with minorities or non-U.S. nationals in their executive suites stand a far better chance of meeting the needs of the diverse communities now online. For example, StarMedia, a Web site serving Latinos worldwide, employs managers from nine countries. That has enabled it to navigate subtle cultural differences, helping boost the site's unique visitors to 27.4 million last December from 12 million in June; revenues tripled to \$61 million in 2000, says Gally A. Baron, Star's chief of staff. "Diversity can really drive a company to go further," says Baron, who is Brazilian. The time for change has come. Diversifying management is not only right, it's also key to winning the markets of the future. ●

Diversity Deficit

Women today make up nearly half of online adults, and more people of color are using the Web. But leaders of Net companies are far more likely to be white males than are their constituents in cyberspace.



Data: Forrester Research, Bureau of Labor Statistics, BusinessWeek



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BY TIMOTHY J. MULLANEY

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Sites Worth Paying For?

The paid Web is a work in progress, but some are already getting it right

The early days of the Web were a great party, no? The CEOs all seemed to be about high school age. And we know what happens when Mom and Dad come home after a high school party. They say: "Somebody is going to pay for this mess." In the aftermath of the Net shindig, Web sites as

big as portal Yahoo! and as small as online magazine Salon hope that convincing people to pay for information and services will be to their income statements what a mop and some Mr. Clean are to a suburban kitchen. But will Web users, weaned on the philosophy that valuable information should be free, start opening their wallets?

The paid Web is still a work in the very early stages of creation. And it's not at all clear which mix of services will make people part with their pennies. But common sense tells us a few things. One, to convince people to pay for online services, they had better be something you can't easily get free somewhere else. And Web services that carry a price will have to have obvious utility. They have to help you make or save money, or greatly simplify something you already do.

By these standards, the early generation of paid Web services is a mixed bag. A look at efforts from Yahoo and financial news site TheStreet.com, as well as the established pay-to-view site ConsumerReports.org, gives some idea of what people can expect—and what it'll take to succeed.

Consumer Reports Online. This \$3.95-a-month site (or \$24 a year, discounted to \$19.95 a year for magazine subscribers) is a beacon of the paid Web. It's even profitable. Surely, one of the grand ironies of the Web's spree of greed is that one of the few content sites with a paid audience and profits belongs to a nonprofit. Consumer Reports Online meets both of my success tests. This site is tailored to help make decisions that can involve tens of thousands of dol-

lars, and Consumer Reports Online's approach separates it from free competition on the Web and elsewhere.

The annual fee gets you access to archives from *Consumer Reports* magazine. And you get detailed reports on cars at \$12 per model. I tested Consumer Reports Online right before my 40th birthday last month. Like any good new 40-year-old, I used it to shop for red convertibles. I pulled reports on a Porsche Carrera (if you think I'd buy something this expensive, let me show you my paycheck), a Mazda Miata (if you think I'm confident enough to buy something this small, you should see my motor-vehicle records), and a Saab 9-3 (still expensive, but closer to the mark). Then I compared what I got from the archives to what's available for free at car-enthusiast site Edmunds.com.

Each site gives you all the basics on options, gas mileage, and such, but Consumer Reports Online's 20-page-plus analyses teach you things Edmunds doesn't. Its breakdowns on safety and resale value are deeper and easier to understand than Edmunds'. For example, Consumer Reports told me that a Toyota Camry Solara convertible is likelier to hold its value than the Saab. That info could save me many times the \$12 the reports cost. People clearly will pay for that.

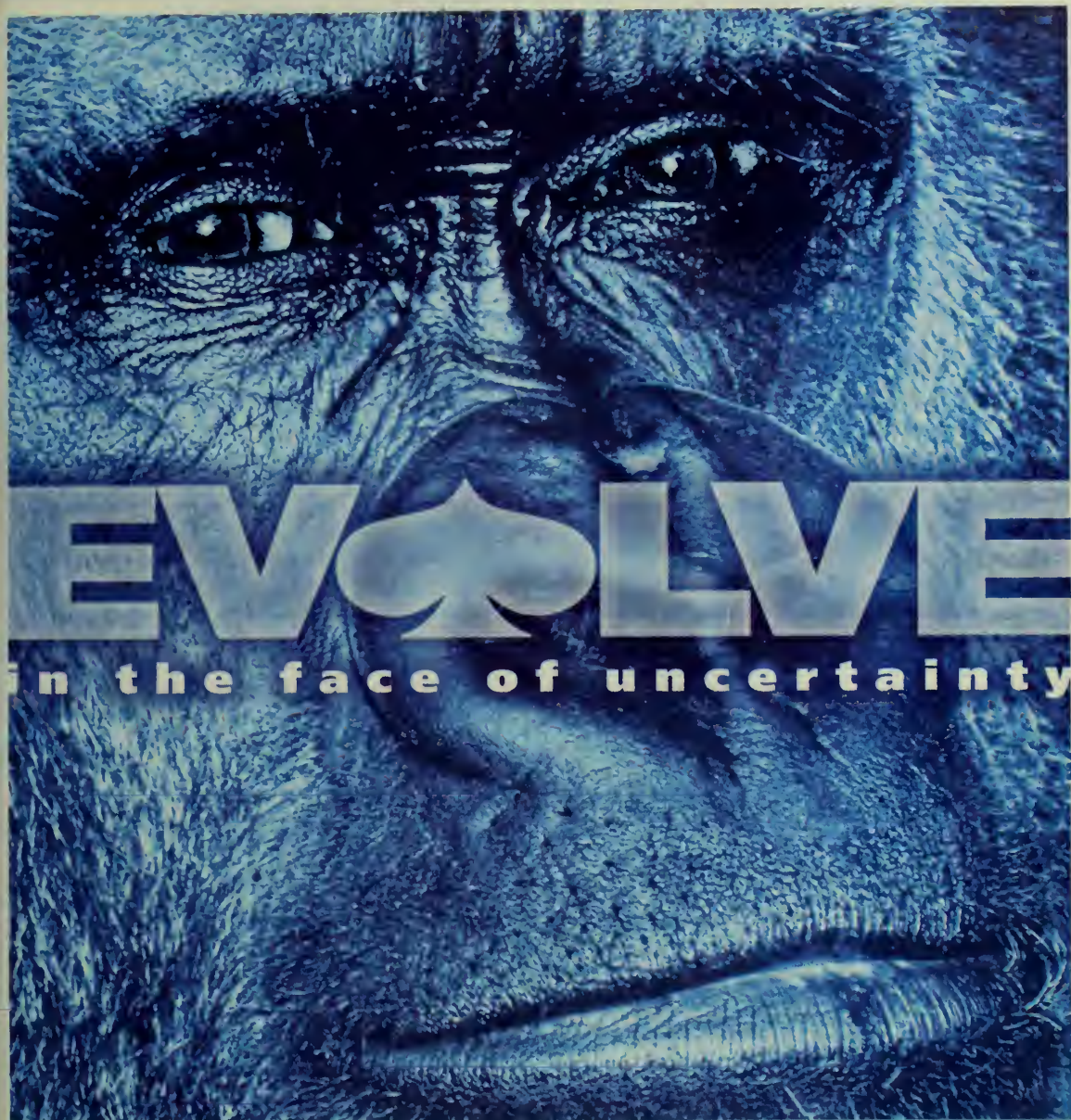
TheStreet.com. I've always liked TheStreet, even though some of my colleagues at *BusinessWeek* grind their teeth about it and gloat over its vanquished stock. The site stubbed its toe trying to charge fees for its basic version, but it doesn't sell enough ads to live by ads alone. So TheStreet is scrambling to find premium subscription services that add more

Web reviews

Pay-for-content sites

- Yahoo!
- TheStreet.com
- Consumer Reports Online





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value. And they're pretty good—for some people, some of the time.

The best of the bunch, I think, is TheStreetPros.com, a sister site where top pundits such as Jim Cramer and money managers such as Don Luskin give unvarnished opinions and investment advice. One example: Cramer's mid-April column promoting Qwest Communications International Inc. It's tightly reasoned—and contrarian enough that, if he's right, people who listen to him will make much more than the \$400 a year TheStreetPros costs. TheStreetPros reminds me of the once-pioneering Dow Jones

Unvarnished opinions and advice from real, seasoned pros are valuable

services (where I once worked) that professional investors paid thousands for. It was no mystery why: We found stuff on short-selling trading that was interesting only to a small number of people—but tremendously valuable to that select few.

This is the kind of stuff some people are likely to pay for. In a market such as today's, it's too much to expect every one of TheStreetPros' tips to pan out. That's not the test. The test is whether TheStreetPros generates information and insight you can't get elsewhere, at a price that's attractive. And TheStreetPros passes this test. Cramer may be a little ubiquitous for some people (me, I love the guy), but he's a real, live professional trader who has made money for clients of hedge fund Cramer Berkowitz. Most of his TheStreetPros buddies are traders, too. The staff at TheStreet's free service, and at competitor CBS.MarketWatch.com, are journalists, many of whom are just a few years out of college. That's why no one pays to read them. The product isn't the same.

Yahoo! It's under more pressure than perhaps any other Web company to find a way to depend less on online ad revenue. Toward that end, Yahoo has started to charge for premium services. Two early examples are its \$4.95-a-month online bill-paying service and its \$9.95-a-month service for a package of real-time stock quotes, including an alert service that tells you when stocks hit a certain price or trade especially actively. For Yahoo's sake, let's hope these offerings are a rough first draft with more to come. This early effort isn't going to cut it.

The basic problem is these services aren't unique. Want free real-time quotes? You can get them anywhere. Try Raging Bull. Want free stock alerts? You'll find them at www.stock-alert.com. On top of that, some of the other

sites offering quotes—such as online trading sites Datek and E*Trade, for instance—also let you put your newfound information to work immediately. That's kind of the point. Yahoo can't directly do that and can't subsidize the service by including its cost in your trading commissions.

The paid Web is likely to be a component of many businesses but the linchpin of only a few. Don't run out and buy dot-com stocks again because the paid Web is coming: A look at TheStreet's numbers will illustrate why. TheStreet lost about \$40 million last year. They'll have to sell lots of \$400-a-year TheStreetPros memberships to fix their problem.

There may be some surprises, though. Think cable tv: In 1975, nobody knew how that would work out, either. Today, a mix of ads and fees collected from system operators pays for cable programming, and services such as Home Box Office cost extra. The Web is looking for a similar mix. And for those sites that don't find one... Paging Mr. Soprano, Mr. Tony Soprano. ●

SOMEONE'S GOTTA PAY

With online advertising on the ropes, Web sites hope to persuade consumers to pay for more of their online information and services. Two factors give you a starting point for assessing whether paid sites are likely to succeed. First, does the site let you make vital decisions or perform important tasks? Second, is the same thing available for free elsewhere? Here's how some pioneers stack up.

IMPORTANT
ENOUGH TO
PAY FOR?

FREE
ELSEWHERE?

Yahoo!

Yahoo is mostly free, but limited services, such as bill-paying and real-time stock quotes, cost money or soon will. But bill paying is free both on and off the Web. Free real-time stock quotes are common, too. Yahoo's long-term plans had better be smarter than the early salvos.



TheStreet.com

TheStreet is trying to salvage its business by offering some information free, but requiring paid subscriptions for services such as RealMoney.com and TheStreetPros.com, which includes recommendations from the site's top pundits. They're worth paying for because these people are worth listening to. And advice this specific is rarely free, even online.



Consumer Reports

Consumer Reports Online is worth the \$3.95 a month or \$24 a year because it can steer you right on purchases ranging from 50¢ chocolates to \$50,000 cars. Other Web sites do product reviews, but no one does them better.





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BY JOAN O'C. HAMILTON

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The Harder They Fall

Many dot-commers have lost more than money, and they're hurting

In late 1999, a twentysomething who I'll call Sam was living very large. He was a mid-level dot-com executive at a Silicon Valley company that was founded in the mid-1990s. By the time the boom was cresting, he was fully vested in stock worth about \$17 million. "When my friends went out, I picked up every check. I gave money to charity. I believed unbelievably in my company," he says. Sam was sure

his future included the freedom to go anywhere "and not have to deal with anybody I didn't want to deal with." You can probably sense what's coming. When I last checked, Sam was still employed, but his net worth—that is, what's left of his stock plus his car—was \$300,000.

Across the country, folks are understandably chuckling at the dot-com-uppance of Silicon Valley's young hotshots. "Darwinism works," snarled a health-care CEO I told about Sam's plight. What's more, while \$16.7 million is quite a drop, \$300,000 ain't chump change. Sam knows that, too. He came to Silicon Valley after college with nothing but his car and a big stack of debts. "If you'd said to me five years ago that I'd have \$300,000, I would have been thrilled," he says. "If only the stock had never gone up so much." But it did go up.

Sam mistook a roller coaster for a rocket ship, and it has taken a frightening emotional toll. At times trembling with anger and at times stammering with shame, Sam told me how in recent months he'd seriously considered suicide. I am sorry and concerned to report that he is among thousands of people staggering around here in Lake Wealthbegen in need of some serious counseling help and



maybe a dash of compassion.

Denial has finally filed Chapter 11 in the Valley. But depression has picked up its lease. For months layoffs were discussed but still hadn't hit in full force, allowing plenty of workers to tell themselves things weren't really so bad. They would compulsively monitor their stocks on their Web browsers and at each positive flicker exhale and say: "Ah, here we go!" Apocryphal stories made the rounds. "Why, I know a gal who got laid off and had a new job that paid twice her old salary by the end of the day!" A lot of people finally took a vacation.

But in just the past few weeks, the mood of the Valley has plunged. As Bob Dylan mumbled and moaned in this year's Academy Award-winning song from *Wonder Boys*, "Things have changed." Now you see people wincing and referring to the downturn as "What's Happened" or "All This," the same way devastated

families create euphemisms when they can't bring themselves to say "since dad abandoned us" or "since my sister's diagnosis." Reed Taussig, a seasoned Valley hand and CEO of Callidus Software Inc. considers himself an "eternal optimist" but says he recently turned to his wife and asked: "What's happened? Did we wake up and Jimmy Carter is President again? Everyone is so depressed."

Another Valley veteran, Roger S. Siboni, the CEO of the

TO A NINE YEAR OLD, "OUT OF STOCK" MEANS "NO BIRTHDAY PRESENT."



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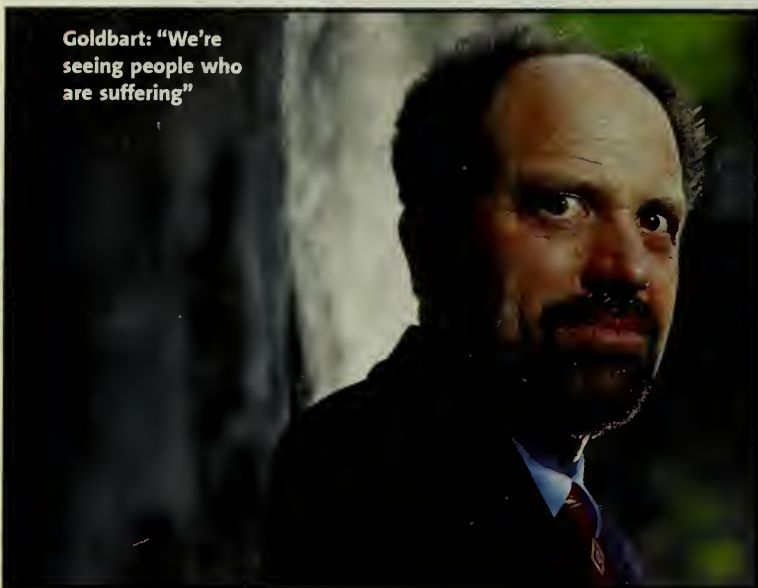
software maker E.piphany Inc., sees plenty of opportunities amid the gloom: He has a cash hoard of several hundred million dollars and says he's now hiring selected people and snapping up technology assets "for the cost of one day of interest on the price of some of our past acquisitions." But Siboni is

amount. Tax crises are brewing all over right now, and a wave of bankruptcies is coming. Sam fears that the despair he sees among many of his peers about how much they've lost or the taxes they owe and can't pay, could lead to devastating emotional breakdowns, and yes, suicides. And it doesn't help that many companies that were once bankrolling every imaginable service from dry cleaning delivered to your cubicle, to company-wide vacations, now are keeping their distance as employees sort through their personal chaos. "I guess they are afraid," says Sam, who's sought counseling help on his own.

Stephen Goldbart is one of the founders of the Money, Meaning and Choices Institute. He and his partner Joan DiFuria initially rose to prominence during the boom when they offered counseling for a disorder they coined that many of us once longed to develop: "sudden-wealth syndrome." Now they're handling more and more clients whose portfolios have been wiped out. "We're seeing people who are suffering," says Goldbart. There was widespread "functional denial" going on among the post-boom babies, he says, but now, "we're watching a shift into a grief process."

Until I spoke with Sam, I had toyed with writing a different kind of column, one about something I had dubbed "Post-Internet Stress Syndrome

Goldbart: "We're seeing people who are suffering"



acutely aware of the resentment that the Valley managed to engender during its wild ride up, and he knows people elsewhere "who are slapping high fives and laughing about 'you Valley guys.'" As for the next time around, "I hope we can be a little more humble on the way up. I hope that's one thing we've learned from all this," he sighs.

Arrogance was not confined to the Valley's Gen-X contingent. But while experienced hands like Taussig and Siboni have lived through some cycles, remember that Sam and his peers were struggling to select a cummerbund for their junior proms the last time the stock market crashed. In Sam's adult lifetime, stocks have only gone up, tech has only been hot. And despite "All This," the truth is that he would still be a multimillionaire today if only he hadn't made a string of absurdly risky financial maneuvers. He used margin loans for all kinds of transactions: to buy real estate, to make big charitable donations, even to pay enormous tax bills. Unwinding the mess created when those loans came due in a falling market meant selling not only his house but the bulk of his stock. Most difficult, he'd become something of a rock star to his family and friends. Now, he feels more like a karaoke crooner a couple notes off key. "You feel like a big idiot," he says.

For all his pain, Sam considers himself in better shape than many of his friends. At least he has no debt. He knows someone who owes over \$1 million in taxes and whose assets are only worth half that

These Gen-Xers have only known stocks to go up and tech to be hot

E-Disorder." Spell the acronym, and you'll get the gist of how much sympathy I had for the New Poor. But Sam's suicide references scared me. H. L. Mencken once quipped that journalists should "comfort the afflicted and afflict the comfortable." Some of these dot-commers have managed to switch from one side of that directive to the other as quickly as their portfolios zipped to the moon and back. They are young and they have been through a catastrophic emotional experience for which they were not prepared, one not much different from watching your house burn down.

The timing is terrible, but I hope companies can spare a few bucks to pro-actively provide or at least recommend some counseling for employees who might be suffering. The years these employees might have spent in entry-level jobs getting perspectives on both business and life they instead spent dragging down a financial fast lane with their peers, confusing their stock portfolios with their self-worth. Still, they weren't doing anything illegal. They were caught up in a much broader mania. And their hubris and manic workstyles were cheered on by plenty of venture capitalists and other common-sense-suspending backers. Let's cut 'em a little slack. ●

POINTERS

➔ The Money, Meaning & Choices Institute in Marin County, Calif., has shifted from helping overnight multimillionaires plan their futures to helping dot-commers cope with losing vast amounts of money. For more information, see www.mmcinstitute.com

➔ One Silicon Valley psychologist believes the high-tech culture became addicted to its workaholic 24/7 lifestyle. She says the downturn is a healthy thing. See a Q&A with addictions expert Dr. Stephanie Brown at www.ebiz.businessweek.com

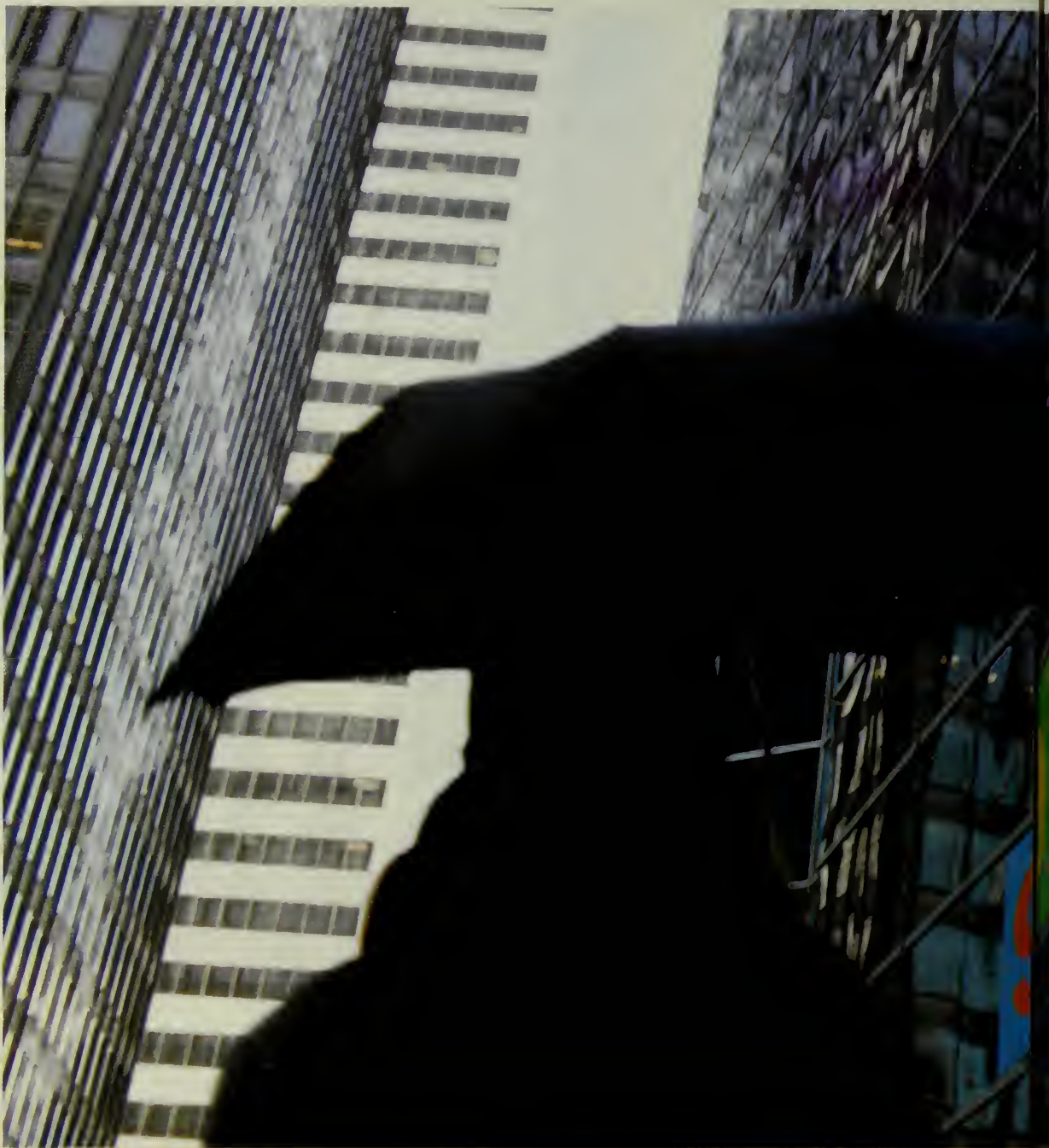


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Failed dot-coms are finding their brands and inventories are nearly worthless

E-Assets for Sale

EToys Inc. is having a fire sale, and almost nobody has come. The Internet retailer filed for Chapter 11 bankruptcy in March and has slowly been selling off assets. So far, the company that once was valued at \$10 billion has brought in about \$16 million for some of its toys, equipment, and content. It hasn't been able to sell the warehouse

management system that it spent two years and \$80 million to develop to ensure that 1 million toys would be under Christmas trees on time. And there have been no takers for eToys' much-heralded search engine that could pull up a list of suggested toys based on a child's age, gender, and preference for, say, Pokémon over Power Rangers. Since eToys' liquidation won't bring enough to pay off its \$285 million in debts, shareholders are unlikely to get anything. Kevin Silverman, an analyst at hedge fund Madison Partners, says he is "shocked" at how little eToys is getting out of liquidation. "Obviously, the original thought of what the eToys brand was worth has changed," he says.

EToys isn't the only failed Internet giant that's seeing its perceived worth get stripped to the bone. Online retailers Garden.com Inc. and Pets.com Inc.—which both shut down before they had to file for bankruptcy—once commanded market capitalizations of more than \$300 million each. Their assets sold for an estimated \$6 million or so apiece. And bankrupt high-speed access provider NorthPoint Communications Group Inc., which once had a market cap of \$5.6 billion, was bought in March by AT&T for \$135 million, even less than its book value of \$146 million.

What's striking about failures in the

Internet sector is how little is coming out of companies that used to be worth so much. The corporate world is loaded with examples of big players that sank into bankruptcy and reemerged for successful encores, including Continental Airlines, Loews Cineplex Odeon, and Boston Chicken. The Net, however, is proving to be a big, black hole. Companies that once had market values of hundreds of millions, or even billions, are simply disappearing. Brand names that were built up with pricey Super Bowl ads and gaudy billboards are hitting the scrap heap. The contrast is stark: While McDonald's Corp. saw enough value in Boston Chicken to preserve its identity, Petsmart.com Inc. bought Pets.com's Web address but didn't want anything to do with the sock-puppet identity of Pets.com. Simply put, there's little intrinsic value in many Net brands, especially ones associated with flawed business models.

What do these early examples tell us about other dot-coms that shut their doors? If investors and entrepreneurs are hoping to reap millions from a liquidation, they're dreaming. Companies that have recently

closed down, including home-delivery service Kozmo Inc. and sports entertainment site Quokka Sports Inc., are likely to get little, if anything, for their assets. So far, it's mostly computers, fax machines, warehouse racks, and other tangible goods that are selling, and they typically go for little more than 30¢ on the dollar. As the pile of dot-com failures grows, a glut of this equipment is likely to drive the going rates even lower. That leaves these companies scrambling to squeeze some return out of Web addresses, content, customer lists, and tailored software pack-



-DIRT CHEAP

ages that they developed themselves.

Good luck. Such assets, which accountants refer to as "intangible," are extraordinarily difficult to value and often impossible to sell because they have little or no use after the company dies. Worse, some valuable items, such as customer information, often can't be sold because of privacy concerns. "People thought being first to market and having a brand name would produce a return," says Hal R. Varian, dean of University of California at

Berkeley's School of Information Management & Systems. "There was a certain amount of irrationality in how those factors were valued."

EToys' BabyCenter is a telling example. When eToys acquired the baby information site for \$190 million in stock in 1999, BabyCenter had virtually no revenues. It was one of the most visited children's sites on the Web, and back then, traffic and visibility were good as gold in the eyes of investors. "They were saying, 'Gee, this thing seems to be growing fast, and it gets a high number of hits, so let's multiply its value by

15," recalls Silverman. When eToys sold the subsidiary, just prior to its bankruptcy filing, consumer products giant Johnson & Johnson paid a mere \$10 million.

Some failed dot-coms, however, are wringing some value from their domain names. Online pharmacy PlanetRX.com, which once had a market cap of \$10.8 billion, announced its liquidation in April and is selling 26 health-related Web addresses through GreatDomains.com. Some of the names—including acne.com, depression.com, and fertility.com—have been bought by pharmaceutical companies at prices ranging from \$50,000 to \$250,000. If those prices hold up, the company could reap \$2 million for its domain names.

The price tags on these domain names might look high, but to many of the buyers, they're bargains. Petsmart bought the name Pets.com and 59 other pet-related addresses from the e-tailer for \$375,000. "We looked at the traffic and what percentage we could convert to customers based on our experience, and then we determined what we were willing to pay to convert them," says Thomas P. McGovern Jr., who runs Petsmart's site. For Petsmart, with \$2 billion in revenues a year, he jokes, "\$375,000 is a small rounding error in our budget."

The intangible asset that may hold the most value for the average dot-com is the customer list. But privacy advocates are going to great lengths to prevent companies from selling such information. Pets.com Chief Executive Julie L. Wainwright made her list off limits, and eToys says it won't sell its



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customer information, unless somebody buys the whole company. Garden.com sidestepped the controversy by selling its list on the condition that each customer would have to give the O.K. before their data were released. W. Atlee Burpee & Co., a 125-year-old garden-supply retailer, took a chance, buying the Garden.com name and customer list for \$2.4 million. "Garden.com attracted young customers, which is something we've struggled to do," says Don Zeidler, Burpee's director of direct marketing, who doesn't yet have data on the percentage of customers who will release their information.

Even tangible assets are becoming more difficult to sell. NorthPoint Communications, which built a digital subscriber line network covering 57 markets, filed for bankruptcy in January and promptly went on tour, offering itself for sale to more than a dozen large telecom companies. All the potential acquirers expressed interest, but on the day the company was to be auctioned off, Mar. 21, nobody showed up. The next day, AT&T bought NorthPoint's equipment for \$135 million—a third of what analysts had thought it was worth.

Furniture, computers, and fax machines aren't fetching much, either. So far, eToys has netted only \$1.2 million for nearly new furniture and warehouse equipment. KB Toys picked up most of its leftover inventory for \$5.4 million—25% of its original cost. "A company might buy something for \$1 million one day, but if they go under the next day, it's worth *bupkes*," notes Patrick Byrne, CEO of Overstock.com, which resells cast-off merchandise.

One by one, the big Internet brands are falling into the *bupkes* pile. Because eToys has not officially declared a total liquidation, the stock of the company is still for sale, meaning someone could buy what remains of the e-tailer and reorganize it into something else. The likelihood of that happening grew dim when children's publisher Scholastic Corp. walked away from its plan to bid on eToys on Mar. 26. Scholastic decided that the investment wasn't worth the expense required to weave eToys' technology into its own computer systems. It's the latest evidence that many dot-com assets are about as valuable as a Game Boy without batteries.

Contributing: Lara Christianson

Net Liquidation

A lot of dot-com shareholders and executives are hoping to salvage something from their failed companies. But as these early examples suggest, the assets of such businesses typically fetch bargain-basement prices.

COMPANY NAME	Peak Market Cap	Estimated Proceeds From Asset Sale
eToys The toy e-tailer sold its BabyCenter unit to Johnson & Johnson for \$10 million and auctioned off equipment for \$1.2 million. KB Toys bought most of its leftover inventory for \$5.4 million, a bargain considering that's only 25% of its cost.	\$10.1 billion	\$20 million
Garden.com Wal-Mart bought the content for \$2 million, and 125-year-old gardening retailer W. Atlee Burpee & Co. snagged the name and customer list for \$2.4 million. What's left? A small amount of inventory and incidentals like computers—all of which is unlikely to fetch much more than 30¢ on the dollar.	\$364.3 million	\$6 million
NorthPoint Communications AT&T bought the bankrupt DSL provider's entire nationwide system, which provided DSL service in 57 markets. Says a spokesman for AT&T: "We were very happy with the price." No kidding. Analysts said NorthPoint's equipment alone was worth at least \$300 million.	\$5.6 billion	\$135 million
Pets.com PetSmart bought Pets.com's Web address for \$375,000. Closeout retailer Tuesday Morning Corp. bought \$6 million worth of Kibbles and sock-puppet mascots for an undisclosed amount that was probably no more than 30¢ on the dollar.	\$325.5 million	\$6 million

Data: Standard & Poor's, company reports

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throw away their
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From left: Pradeep Sindhu, Juniper Networks; Paul Bourke, Altra Energy; Rick Belluzzo, Microsoft; Jeff Bezos, Amazon.com; Bill Coleman, BEA Systems



25 Leaders for a

The Internet forced a revolution in the way companies are managed. For the CEOs of upstarts and Old Economy players alike, the focus has been on making decisions in a heartbeat, innovating fast, and looking for ways to tap the Net to reach new customers and streamline operations. Now we're in the midst of what experts say could be the biggest tech slowdown in 15 years. With the pressure on to cut costs and meet quarterly earnings expectations, what's a CEO to do?

Ask our e.biz 25. These are the most influential people in e-business—everybody from empire builders like AOL Time Warner Chairman Steve Case to Monica Luechtefeld, executive vice-president of e-commerce at retailer Office Depot. Those two have wisely built bridges between the worlds of bricks and

clicks. Their advice is bold: Don't just hunker down and try to wait it out. Invest, build, develop new products, and prepare for the upswing. Technology and the Internet may not be growing lickety-split, but they aren't going away. Says Jeffrey K. Skilling, CEO of Enron Corp., one of our 25: "A lot of people will pull back. They will be missing tremendous opportunities. Those with capital and talent should push forward and widen the lead."

Doing this in the face of a trigger-happy Wall Street will require dynamic leadership and cast-iron stomachs. We've got that on our e.biz 25. These are the pioneers, the people with the new ideas, the out-of-box thinkers, and the survivors—especially the survivors—who will shape e-business for years to come.

Some of our 25 have been on the list before. Michael Dell, CEO of Dell Computer Corp., for one. He's a pioneer who has used the

the list

28 EMPIRE BUILDERS

Monica Luechtefeld, Office Depot
Stuart Wolff, Homestore.com
Meg Whitman, eBay
Thomas Middelhoff, Bertelsmann
Steve Case, AOL Time Warner

36 ARCHITECTS

Rick Belluzzo, Microsoft
Bill Coleman, BEA Systems
Scott McNealy, Sun Microsystems
Tony Ball, BskyB
Michael Powell, FCC Chairman
Pekka Ala-Pietila, Nokia

44 VISIONARIES

Lawrence Lessig, Stanford
Hal Varian, U.C. Berkeley



Above: Ray Ozzie, Groove Networks. Right: Monica Luechtefeld, Office Depot

From left: Hal Varian, University of California at Berkeley; Lawrence Lessig, Stanford Law School; Stuart Wolff, Homestore.com

Dangerous Time

let to reach customers and revamp his supply chain. Now, in the midst of the downturn, Dell is turning up the heat on competitors by slashing prices ruthlessly. Thanks to his foundation of Net technologies, Dell can do this and still make a profit. The result could be a massive restructuring of the PC industry, with some of Dell's competitors losing market share at a gallop.

Others land on the list because of their potential for shaking up the status quo. Example: Rick Belluzzo, Microsoft Corp.'s president. Microsoft has been ho-hum on the Net—until now. Belluzzo has turned Microsoft's MSN into the No. 2 portal on the Web, and now the company is committed to spending \$2 billion this year on research & development for its .Net strategy for supercharging the Web. It may well make the Net more useful—and easier to use. And Microsoft could leapfrog from laggard to leader.

Then there are the folks whose future is very much in doubt—and that makes them even more important to watch. Squarely on the e.biz hot seat sits Jeff Bezos of e-tailer Amazon.com Inc. With the online superstore's revenue growth slowing and its \$15 stock off its peak by 85%, the man who scared the bejesus out of the nation's traditional retailers isn't so terrifying now. But he's still the trailblazer of e-tailing. Whether he fails miserably or triumphs in the end, how he fares will tell us much about the next episode in the Internet saga. "This is a good time to learn, to explore, to get ready," says Rosabeth M. Kanter, professor at Harvard Business School.

Indeed, economic slumps have been launchpads for companies who know how to take advantage of them. The outfits that are likely to pick up momentum in this downturn are the

52 WEBSMART

INNOVATORS

- Ray Ozzie**, Groove Networks
- Courtney Love**, Hole
- Paul Bourke**, Altra Energy
- Takeshi Natsuno**, NTT DoCoMo

- Michael Dell**, Dell
- Pradeep Sindhu**, Juniper Networks
- Jeffrey Skilling**, Enron
- Gary Reiner**, General Electric
- Steve Sanger**, General Mills

58 ON THE HOT SEAT

- Jeff Bezos**, Amazon.com
- Marty Wygod**, WebMD
- Masayoshi Son**, Softbank

companies that create or adopt new technology, experiment with new business models, and expand aggressively. That's certainly been true in the past. During the 1990-91 recession, EMC Corp. focused on high-end storage technologies and innovated its way through hard times. Chrysler retooled its design process and began farming out component manufacturing to partners—and was the only one of the Big Three to post a profit in 1992. Arrow Electronics bought smaller competitors and expanded in Europe, emerging as the No. 1 electronics distributor in the world. "Slowdowns can be a great opportunity for companies that are prepared. It's time for the strong to get stronger, and for the relatively weak to get stronger, too," says Orit Gadish, Chairman of consulting firm Bain & Co.

'It's time for the strong to get stronger'

The Internet's early winners focused on boosting sales. But during a downturn, that's not nearly enough. The Net can be used to supercharge every aspect of a company's operations, from market research and customer service to engineering collaboration and linking up suppliers. Consider e.biz 25 member Pradeep Sindhu, co-founder of Juniper Networks Inc. He used this wall-to-wall approach to make his four-year-old upstart the leader in high-end network routers. It was built from the ground up to capitalize on the Net. The company takes orders over the Web and automatically passes them to contract manufacturers who make and ship the products. This frees Juniper to concentrate on designing products that trounce the competition. The payoff: Juniper's operating margin hovers around 30%, nearly double the average in the hardware business.

The most successful e-businesses don't just chase the latest hot idea. They figure out which technologies are really right for them. Gary M. Reiner, chief information officer at General Electric Co., one of our e.biz 25, turned up his nose when many industrial companies joined consortiums that set up public e-marketplaces. GE has instant economies of scale with its 11 different businesses, so it can reap huge savings by combining all their buying into the company's own private e-marketplace. GE expects to save \$600 million on procurement over the Web in 2001.

Many established companies rapidly spun off independent Internet divisions, and for some—NBC, for example—that turned out to be a mistake. The latest thinking is that companies like retailer Office Depot got it right. It set up an independent organization,

run by Luechtefeld, but its bricks and clicks are cemented together. For instance, customers who need something immediately can check online to see if the item is in stock at their local Office Depot. The company logged \$850 million in online sales last year, making it the No. 2 online retailer after Amazon.com

In a downturn, charismatic leadership is more important

than ever. With revenues sinking and stock options underwater, workers need reasons to believe. "You have to persuade people to stay with you for the ride," says Haim Mendelson, a professor at the Stanford Graduate School of Business. While most companies are laying off, some, like Sun Microsystems Inc., pledge to do so only as a last resort. CEO Scott McNealy, one of our e.biz 25, believes layoffs break a social contract with

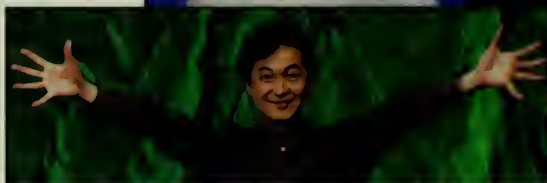
employees. By holding back, "we're protecting the long-term shareholder value," he says.

For CEOs who have been the company's visionaries during the Net's gogo years, now is the time to buckle down and pay attention to

operations. It's advice that Amazon's Bezos takes to heart. The company's goal is to post an operating profit—excluding special charges—in the fourth quarter. He's concentrat-

ing on operating efficiencies. And he's using Net technology to get there. Right now, Amazon is installing a system that will automatically route e-mails from customers to the appropriate service representative, saving time and money.

Bean-counting may be back, but so is fear. And leaders who let themselves be ruled by fear won't be able to handle the balancing act that's required of them in these difficult times. "Some people pay lip service to the principles of leadership, but they flush it away when they're running scared," says Raymond Miles, professor emeritus at the Haas School of Business at the University of California at Berkeley. These 25 show no sign of turning tail. ●



Clockwise from above left: Meg Whitman, eBay; Michael Powell, FCC; Masayoshi Son, Softbank; Takeshi Natsuno, NTT DoCoMo

Who is making money online? And how are they doing it? Watch TechTV on your cable system Monday, May 7, for an update on the state of e-business and insights from the e.biz 25. All day long, TechTV and techtv.com will feature insider reports, forecasts, products, services, and the people who are shaping the future.



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empire builders

Monica Luechtefeld, the executive vice-president who heads Office Depot Inc.'s online business, has little patience for people from other companies who complain to her that they can't get e-commerce off the ground. "Doesn't your chairman grill you daily about online performance?" she recalls asking one such whiner at a recent industry conference. When he answered "no," Luechtefeld scolded, "Shame on you and your company. No wonder you're failing."

Luechtefeld has earned the right to be smug. Under her leadership, the Delray Beach (Fla.)-based company has quietly become the second-largest e-tailer in the world behind Amazon.com. Office Depot booked \$850 million in online sales last year—double that of its biggest rival, Staples Inc. Last year, Internet sales grew 143% from the \$350 million in 1999. The outfit has been profitable since it was created in 1996. And this year, online sales are expected to nearly double, to \$1.5 billion, representing 20% of the company's overall sales. Now, she aims to push to 50% from 40% the number of Office Depot customers ordering online by yearend. "Our success is measured not by traffic to the site, but by sales," says Luechtefeld. "What differentiates us from others is execution."

Luechtefeld provides a case study in how best to marry bricks with clicks. Not only can the company's corporate and individual customers order 14,000 items online—twice as many as in the stores—but they also can check the inventory at

MONICA LUECHTEFELD



Office Depot Inc., Executive Vice-President, E-Commerce

» **CONTRIBUTION:** Made OfficeDepot.com the second-largest e-tailer after Amazon.com.

» **CHALLENGE:** To raise the percentage of Office Depot customers buying online to 50% by yearend from today's 40%.

that shop at Office Depot. To do that, she plans to offer them more than just office supplies. "I want us to serve them both as coach and trusted adviser," she says. To Luechtefeld that means expanding to include online services such as tax preparation and bookkeeping. Office Depot has no expertise in this area, so Luechtefeld is making alliances with those that do, including software giant Microsoft Corp. Such moves win raves from Charles Martin, chairman of the Net Future Institute, a New Hampshire think tank that studies e-commerce. "Office Depot has used the Net to lock customers into a deeper relationship," he says. "Someday, they'll be able to sell them other things such as airline tickets."

Luechtefeld has deep experience in selling businesses all manner of things. The 52-year-old Los Angeles native left furniture supplier Eastman Inc. in 1993 to join Office Depot. She began her career at the company running its massive operations in Southern California, overseeing distribution, ware-

Our success is **measured** not by traffic, but by **sales**

any of the company's 850 U.S. superstores via the Net. If a customer orders something online, a nearby store will package it for pickup at the customer service desk. No more standing in line. And computers at the stores allow walk-in customers to check online to find out such things as what type of cartridge they need for a certain printer and whether it's in stock. The idea is to create a seamless experience for customers where retail and online operations feed off each other.

Still, the online effort is just a toddler in Luechtefeld's eyes. Next, she plans to expand beyond the company's thousands of big corporate customers to serve the 13 million small businesses

housing, and sales. Next, she moved to headquarters to handle marketing. Thanks to her training, when the Internet emerged she understood immediately how it could not only boost sales, but also cut costs. Online sales are half as expensive to process as orders received via fax or phone. And she was convinced corporate purchasing managers would love the Net, too. It would let them control policy and the purse strings from above but push actual buying down into the trenches. Luechtefeld persuaded her superiors to let her try to make Office Depot No. 1 in online sales of office supplies.

Job done. Thanks to Luechtefeld, there's no whining at Office Depot. •

ILLUSTRATIONS BY RICH ULLASH





empire builders



While other dot-coms are failing, Homestore.com Inc. gets stronger. It has the most popular collection of real estate sites on the Web. Better yet, it has been profitable for three quarters, and its stock is trading at about \$30 a share—twice what it was a year ago when Net stocks tanked.

Credit CEO Stuart H. Wolff and Homestore.com's unique business model. Other dot-coms tried to vanquish the Old Guard, but Homestore.com formed alliances with the real estate Establishment. "The rules of business are not going to be rewritten," he says. "The Internet is just a tool. The companies that do just the Net will be few and far between."

Homestore.com began as the online operation of the National Assn. of Realtors, a 750,000-member trade group. Wolff, then entrepreneur-in-residence at cable TV company TCI International Inc., put together financing and bought the money-losing site. Wolff, 37, strengthened his industry ties by paying local realtor groups for listings.

Wolff's not in the clear. His online ad sales have flattened out. But he has the time and money to get these old bricks clicking on the Net. ♦

« STUART WOLFF

Homestore.com Inc., Chairman and CEO

» **CONTRIBUTION:** He showed dot-coms can succeed by joining forces with the Establishment, rather than fighting. He teamed with the National Association of Realtors to bring house shopping to the Net and now boasts 7.2 million visitors a month, twice that of his top rival.

» **CHALLENGE:** To keep growing during the economic slowdown, which could hurt housing sales.

Everybody in e-business wants to be Meg Whitman. And why not? The chief executive of eBay Inc. has created the Net's one blockbuster success. Behind eBay's flea-market facade is the world's biggest place to buy and sell everything, from \$4 baseball cards to \$4 million hotels. Profitable eBay now hosts more than \$5 billion in annual gross sales, with juicy, software-like 83% gross margins. Crows Whitman: "We have created one of the strongest companies in recent times."

Unlike most dot-coms that tried to turn the Net into TV or the mall, Whitman tapped into its root appeal, communications, letting people trade among themselves. And in contrast to many dot-coms, she pinched pennies from the start.

Whitman's ambitions, however, have always been grand. She predicts eBay will host \$30 billion in gross sales by 2005, for which its

10% cut would mean \$3 billion in revenues. But tough international competition and the slowing economy could intervene. Says W.R. Hambrecht & Co. analyst Derek Brown: "The next wave of growth is likely to be a bit more difficult."

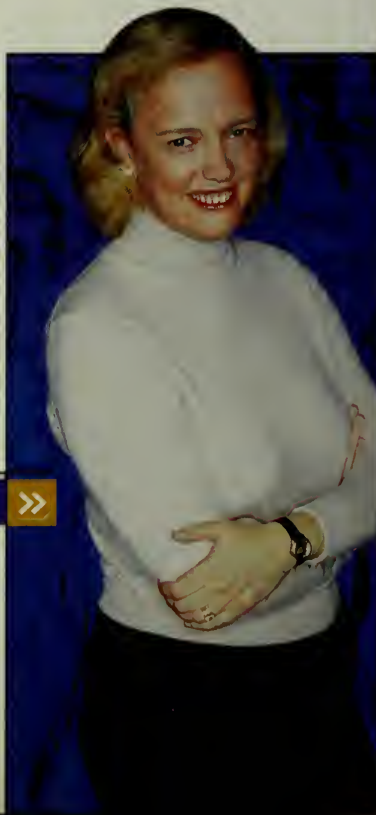
Her big bet: a new drive to help online sellers meld eBay auctions into their own Web sites, potentially making eBay's technology as pervasive as Microsoft Corp.'s Windows. Look out, warns Munjal Shah, CEO of auction-services provider Andale Inc.: "We're going to talk about eBay over the next five years the way we talk about Microsoft today." That's a problem Whitman's e-biz peers would love to have. ♦

» MEG WHITMAN

eBay Inc., CEO

» **CONTRIBUTION:** Turned eBay into the largest site for e-commerce, with 30 million registered users. Remarkably, the site has been profitable since it began in 1996.

» **CHALLENGE:** As the economy slows and international competition heats up, fulfilling a recent promise to handle \$30 billion in sales by 2005 could be tough.



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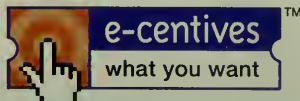


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empire builders

Thomas Middelhoff seems far from Nasdaq's turmoil as he sips red wine and puffs a cigar in his wood-paneled dining room. The dot-com crash has barely dented the faith of Europe's top Net booster. "We believe e-commerce is a permanent part of the media business," says Middelhoff, chief executive of media giant Bertelsmann.

More than any other media company in Europe, Bertelsmann is remaking itself for the digital world. The company earned \$7 billion on early investments in America Online Inc. In 1998, Middelhoff ordered that all Bertelsmann's books and musical recordings be digitized so they could be sold online. And then, in October, he sunk \$60 million into Napster Inc., the renegade music file-sharing service.

Not all of his bets have paid off, though. In November, Bertelsmann

closed its anemic online auction site. And in case Napster doesn't work out, Middelhoff has joined a group that is developing a secure way to download digital tunes. Next up: Using the Net to help Bertelsmann's money-losing book clubs. In the U.S., club Web sites already bring in a third of all new members. Middelhoff may still be tinkering with the formula to make all his Net initiatives pay, but he's not turning down the volume. ●

THOMAS MIDDELHOFF >>**Bertelsmann, CEO**

>> **CONTRIBUTION:** He made Bertelsmann the first major European publisher to sell books, music, and magazines over the Web. And he shook up the music biz by forging an alliance with maverick Napster.

>> **CHALLENGE:** To use e-commerce to turn around money-losing book clubs and boost lackluster profit from music sales.



Steve Case runs AOL Time Warner, arguably the most powerful company on the Net since the merger of America Online Inc. and Time Warner. What's he doing with his new clout? Moving beyond the role of company visionary to industry statesman.

His goal: to make sure new rules for the Internet won't inhibit his company, or the growth of the Net. At a March bipartisan congressional retreat, he urged lawmakers to strike a careful balance, seeking common ground, for instance, between consumer demands to download music from the Net and the recording industry's desire for copyright protection. Case, 42, believes having separate rules for TV, telephony, computing, and music doesn't make sense when the boundaries between industries are blurring.

Back at HQ, he's pushing hard for innovation. "We believe television, the telephone, and stereo are important in people's everyday lives, not just the PC," Case says. "The real opportunity for us is to build bridges between them to help facilitate new kinds of products and services." If he can get AOL Time Warner's far-flung operations working together, he'll prove himself a statesman in more ways than one. ●

<< **STEVE CASE****AOL Time Warner Inc., Chairman**

>> **CONTRIBUTION:** He brought the Net to 29 million people via an easy-as-pie online service. Now, with the acquisition of Time Warner Inc., he sits atop the most powerful empire of new and old media.

>> **CHALLENGE:** To generate synergies and new businesses by using AOL's brand and digital infrastructure to leverage Time Warner's entertainment, news, and cable operations.

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**Would you rely on an e-business strategy
before seeing that it works?**



architects

Richard E. Belluzzo wasn't the obvious choice to run Microsoft Corp.'s Web business before he took the helm nearly two years ago. After all, he cut his teeth as a hardware guy running Hewlett-Packard Co.'s printer and computer businesses. To some on Wall Street, Belluzzo was an old tech fuddy-duddy in a world of new tech wunderkinder. No more. As the dot-com bubble burst and former hotshot Web portals such as Lycos and Excite@Home lost steam, Belluzzo, 47, spearheaded the turnaround that elevated Microsoft's msn to the second most popular portal, with 50 million visitors last month to Yahoo's 56 million. On Valentine's Day, Microsoft promoted Belluzzo to president and chief operating officer. His efforts helped put Microsoft on our e.biz 25 list for the first time.

If you think his first act was odds-defying, just wait for his encore. Belluzzo is leading the charge as Microsoft seeks to become a major toll collector on the Web. If he succeeds, Microsoft could become as dominant on the Internet as it is in the PC world. Belluzzo's task is to gin up a subscription business for Microsoft's Web services. Central to his effort is HailStorm,

grams on PCs. With one click, the user can trigger a cascade of actions without having to open new programs or visit new Web sites. For example, in one step, investors could transfer money from their bank account to their brokerage and buy a stock and have it automatically updated in their personal finance software records.

The goal is nothing short of reinventing how people use the Web. Microsoft Chairman William H. Gates III says this will switch the Internet "from a hub-and-spoke design into a true Web of interacting services that are tailored to the exact needs of you or your business."

Belluzzo, a hard worker who grew up in a blue-collar family, deserves much of the credit for getting MSN on the right track. When he arrived at MSN in 1999, he focused a scattered organization on the most important things that people do on the Web: getting online, finding what they want, and communicating with one another. Since then, MSN.com vaulted past all but Yahoo.com as the most visited portal in the U.S. MSN's free e-mail service Hotmail is closing in on

director of business development.

Competitors already are crying foul. Microsoft plans to build links to HailStorm from its Windows operating system, which is included on more than 90% of all PCs sold. It's an advantage that no other company has. "They want

RICK BELLUZZO

Microsoft Corp., President and COO

>> CONTRIBUTION: He reversed the fortunes of Microsoft's consumer Web business, making MSN the second-most popular family of Web sites on the Net after five years of fits and starts.

>> CHALLENGE: Building a new Web business by adding subscription services like stock trading alerts through Microsoft's .Net technologies.

to control things," says Sun Microsystems Chief Scientist Bill Joy. Still, that monopoly didn't guarantee victory for Microsoft when it bundled access to its proprietary online service, The Microsoft Network, into Windows. Launched in 1995, the service tried to compete head-to-head with AOL but was thoroughly trounced. Belluzzo points out that competitors bring their own advantages. AOL,

Belluzzo's task: to sell Web services people are

a service that will let companies shoot messages to customers' PCs, handhelds, cell phones, or pagers if their flight is late, their credit is overdrawn, or a product they've ordered has been shipped. When Microsoft rolls out the service next year, it plans to charge consumers a few dollars a month. "It's the best opportunity we've ever had to be a major player on the Internet," Belluzzo says.

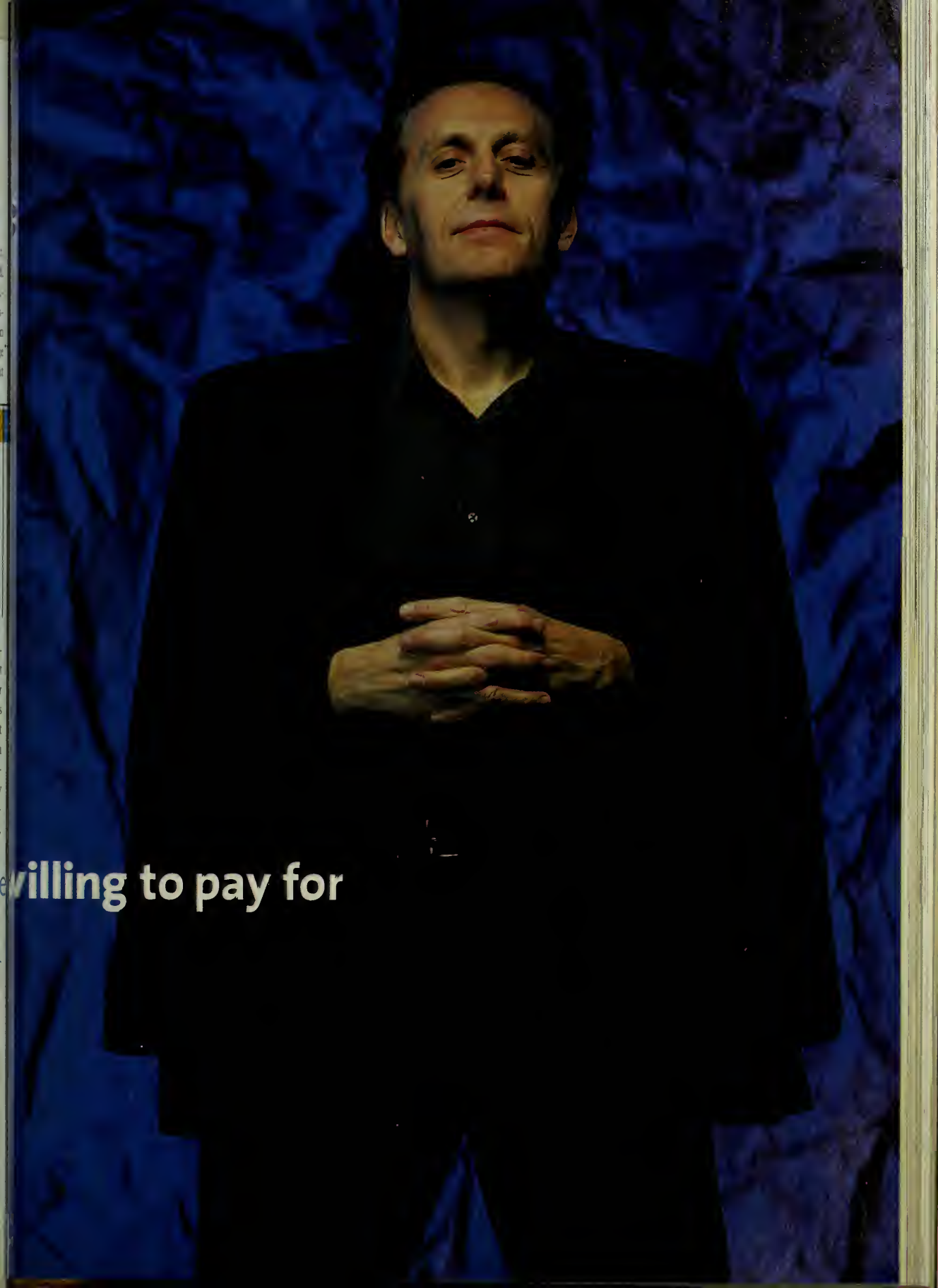
That's just one piece of Microsoft's broad Web services strategy, dubbed .Net. Launched a year ago, .Net is a sweeping set of technologies that will let unrelated Web sites talk to one another and to pro-

its 100 millionth account, making it the largest free e-mail service. MSN Messenger Service has 29.5 million users worldwide, edging out each of America Online's two messenger services. And, now with 5 million customers, MSN trails only AOL in on-line access customers.

That work is one of the cornerstones of .Net. And the new technology is starting to win converts. Online auctioneer eBay Inc., for instance, is building a HailStorm system to notify customers via instant messages when their bid has been trumped. "Microsoft makes it easy," explains Gil Penchina, eBay's senior

he says, benefits from having billing relationships with 29 million subscribers.

With a plan in hand and plenty of competition, Belluzzo is raring to go. He, Gates, and CEO Steven A. Ballmer will bake .Net into every Microsoft product and work hard to get developers and business partners to buy into the new strategy. The hardware veteran is betting that software will reign supreme in the next phase of the Internet. And that's a battle Microsoft thinks it can win. "We're changing the rules," Belluzzo says. Ain't nothing fuddy-duddy about that. ●

A full-length portrait of a man with dark hair, wearing a dark suit and a dark shirt. He is standing with his hands clasped in front of him, looking directly at the camera with a neutral expression. The background is a vibrant blue, crumpled fabric that creates a textured, wavy pattern. The lighting is soft, highlighting the contours of his face and suit.

e willing to pay for



architects

When William T. Coleman III started BEA Systems Inc. six years ago, he and his wife, Claudia, made a pledge: Half of the money he made from the new software company would be put toward research into technology to help people with learning disabilities.

Coleman had no idea how much that moment of altruism would eventually be worth. As it turns out, a lot. Today, the company's annual revenues are pushing \$1 billion, and growth was a healthy 71% last quarter. His stake in the company is worth \$500 million, and in November, Coleman, 53, made good on his charitable promise. He agreed to donate \$250 million to a center for cognitive disability research at the University of Colorado.

While other e-business software companies such as purchasing specialist Ariba Inc. are struggling, BEA is strutting its stuff. That's because it makes the crucial software tools corporations need to quickly and efficiently build large and complex e-business applications. It handles everything from e-commerce Web sites to managing supply chains. "BEA has the chance to be the next great software company," says Sun Microsystems Inc. President Edward J. Zander.

Coleman has made his own luck. After working in software development at Sun for 10 years, he set out to be an entrepreneur, even though it meant leaving behind stock options that would be worth \$72 million today. He and two others started BEA to create software tools that tie corporate software applications together.

Then, two years ago, Coleman had an epiphany: A fortune could be made in selling the underpinnings of e-business systems. He acquired WebLogic Inc., a maker of server software that acts as a foundation for Web applications—which now accounts for 70% of BEA's revenues.

He also bought another 23 upstarts.

Analysts question whether BEA can stay ahead of its competitors forever. With giants such as IBM applying pricing pressure and catching up on the technology front, BEA's position isn't secure. It could use its relatively healthy stock—now trading at \$43—to gobble up floundering Net software companies. Or it may move up into applications like customer management to keep growing at a rapid rate.

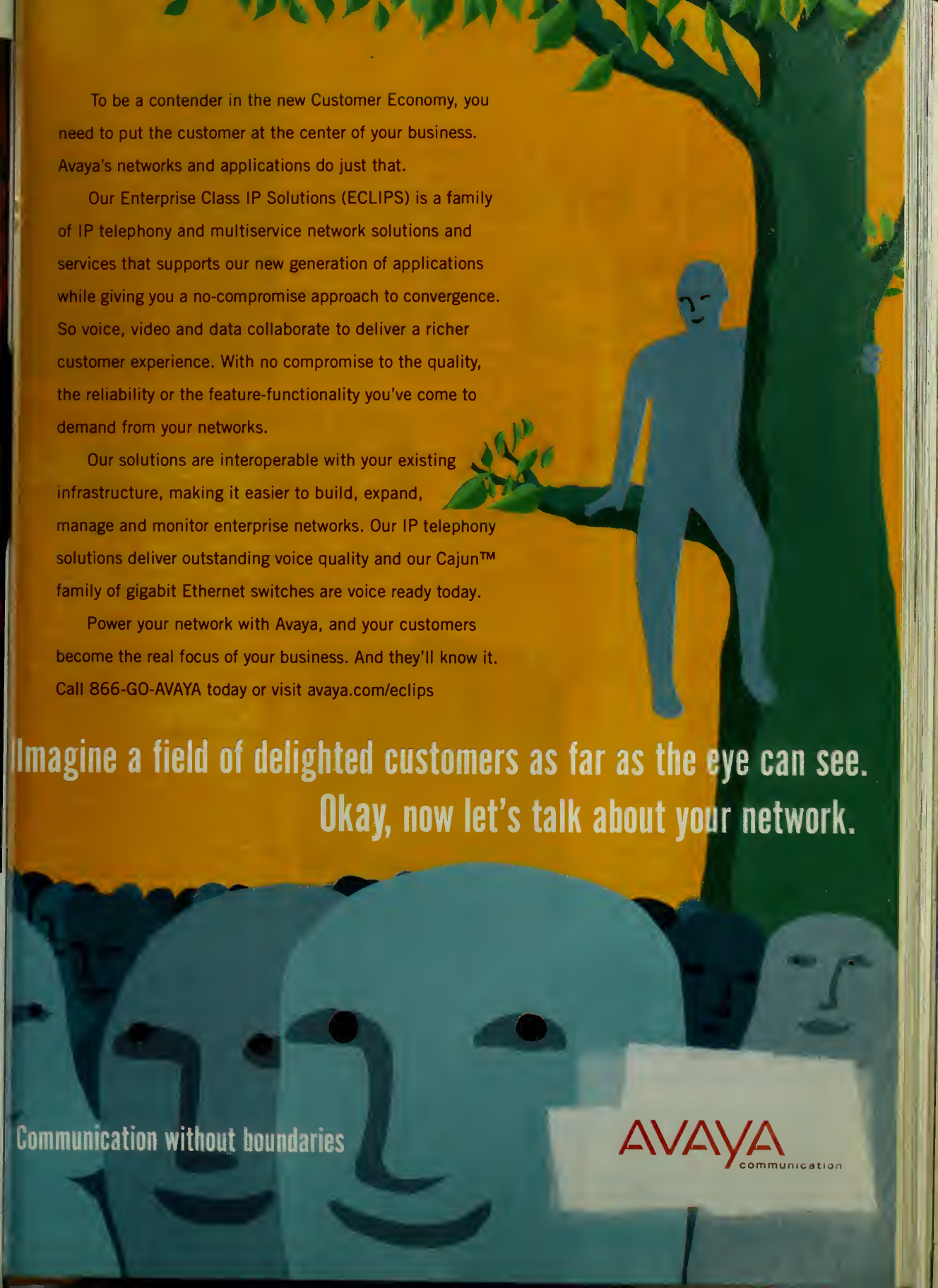
Coleman isn't worried. "There can be only one giant in this business," he says. "I believe we have enough of a lead for that to be us." The Microsoft of e-business? Somebody's got to do it. ●

BILL COLEMAN**BEA Systems Inc., CEO and Co-Founder**

» **CONTRIBUTION:** BEA has rocketed to the top, making software upon which corporations build e-commerce and e-business Web sites.

» **CHALLENGE:** Must hold off a bevy of big rivals, including IBM, Oracle, and Sun Microsystems.





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architects

Tony Ball doesn't spend much time surfing the Web from his PC. Not that he doesn't like the Net. But when Ball wants to go online, he's more likely to click on his 48-in. flat-screen television in the office. It makes sense: The 45-year old is CEO of Europe's leading interactive TV broadcaster, British Sky Broadcasting Group PLC.

Bskyb is doing more than any other company to transform the old-fashioned TV into an Internet device. Its subscribers get some 200 channels and can send e-mail, order pizza, or buy books from their TVs. The service is doubly important in Europe, where only a quarter of households have PCs, compared with more than half in the U.S. By contrast, 23% of British homes use interactive TV, vs. just 2% of Americans, says researcher Jupiter Media Metrix Inc. Europewide, Jupiter expects 53 million households—33%—to use I-TV by 2003. "Although the PC won't go away,

you need the ultimate trusted device to reach a mass audience—the television," Ball says in his clipped Cockney accent.

Bskyb reaches more of that audience than anyone, serving 5 million British homes. Now, it aims to expand around the world. Bskyb has bought 22% of Germany's Kirch Pay TV. And News Corp., which owns 37% of Bskyb, plans to roll in broadcasters in the U.S. and Asia to create a global powerhouse.

Sure, there are obstacles. The German operation is struggling to pick up subscribers. And last year, Bskyb lost \$350 million as it gave away set-top boxes and satellite dishes in a bid to woo customers. But Bskyb more than doubled its subscribers in 2000, and analysts say it should be profitable by next year. So expect to find Tony Ball directing the show as the TV challenges the PC as the way to the Net. ●



TONY BALL

British Sky Broadcasting, CEO

» **CONTRIBUTION:** Built the world's largest interactive-TV broadcaster, letting more than 5 million customers send e-mails, customize news reports, and even buy pizza online.

» **CHALLENGE:** Turn couch potatoes into active I-TV surfers, persuading them to spend more money online.

SCOTT McNEALY

Sun Microsystems Inc., Chairman and CEO

» **CONTRIBUTION:** McNealy declared more than a decade ago that "the network is the computer." The Internet proved him right. Sun's servers and Java programming language are the foundation for many top Web sites.

» **CHALLENGE:** No company was ramping up faster than Sun when the slowdown hit. McNealy will have to adjust without sacrificing long-term goals.

Back in 1984, when Scott G. McNealy, then the acting president of Sun Microsystems Inc., hired Crawford Beveridge to be the startup's human resources chief, he told him to hire a "real" president. "Thankfully," says Beveridge, "I never got to that task."

It's a good thing for Sun and for the Internet. No other tech executive has done more than McNealy to spot e-business opportunities and turn them into reality. When the Net went bonkers in 1995, McNealy was all over it. Sun



developed the Java programming language to make it possible to write software that could run on all computers, and its muscular servers provide the horsepower for most major Web sites.

Now, McNealy is focused on selling more than just servers. Sun is assembling soup-to-nuts offerings that include storage, software, and related technology to help service providers expand their offerings—whether it's shuttling wireless e-mail to consumers or providing powerful back-office applications to corporations via the Web. "We're trying to find as many useful ways as possible to connect everyone, everywhere to the Net," says McNealy.

Making progress toward these grand ambitions won't be easy in this economic slowdown. Sales in the most recent quarter grew just 2%, and Sun will be tested to avoid the layoffs that have plagued others. What's more, Sun's software and storage efforts have so far been uninspired. eBay, which agreed to try new storage devices last year, recently dumped Sun for Hitachi Data Systems.

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Five years ago, Nokia Corp. produced an odd-looking beast: a brick of a cell phone called the Communicator, which opened up to reveal a tiny Web-surfing computer. The machine was clunky and offered painfully slow Web service. It was one of the rare Nokia phones that lost money. So why bother? Pekka Ala-Pietila, then head of Nokia's cell-phone division, said simply: "This is the future."

The mobile Net is still more promise than reality. But it's coming, and Nokia is leading the way. By 2003, virtually every phone Nokia makes—150 million annually—will be Web-enabled. That means Nokia will build more Net machines than anyone. And as Nokia's president and chief Internet strategist, Ala-Pietila will have a big hand in shaping the future of electronic business.

The Web he imagines is made up of as

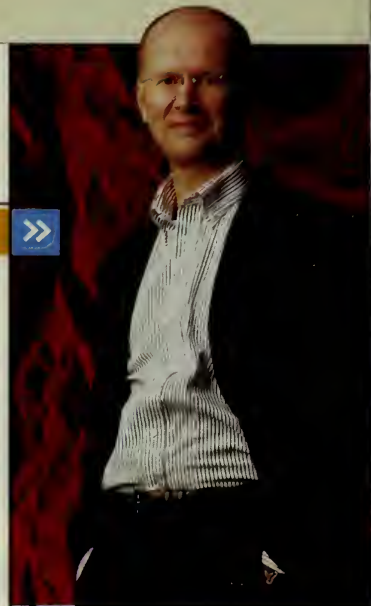
PEKKA ALA-PIETILA

Nokia Corp., President

>> CONTRIBUTION: He's one of the biggest champions of the wireless Web and produced the first Web phone five years ago. By 2003, Nokia could sell 150 million Web-ready phones a year.

>> CHALLENGE: To extend Nokia's dominance to the Net, he must make software, taking on new rivals such as Microsoft.

much software as hardware, Nokia's traditional strength. Ala-Pietila is tapping the smarts of 20,000 engineers to develop both machines and applications that will bring this new Web to life. The company is working on new camera phones and music players. It is putting together mini-Web portals and browsers. And Nokia is building security systems that will allow



users to bank and shop via their phones.

Nokia's chairman, Jorma Ollila, calls 44-year-old Ala-Pietila "my vision man." The vision Ala-Pietila is building should keep Nokia in the forefront as the future arrives at last and the Net goes mobile. •



MICHAEL POWELL

Federal Communications Commission, Chairman

>> CONTRIBUTION: Powell's pro-deregulation stance promises an era when telecom mergers will get quick go-aheads and more wireless spectrum will be made available for Net services.

>> CHALLENGE: To promote the wireless Web, he'll have to wrest valuable spectrum from the Pentagon or the powerful broadcast lobby.

If you're in Washington and see a crowd of reporters, chances are good you'll find Federal Communications Commission Chairman Michael K. Powell in the middle of it. Although he rarely gives them anything newsworthy, they keep after him, prompting him to call them "my groupies." Celebrity status for the country's top regulator may seem, well, weird. Still, since he took the job three months ago, Powell's views and the fact that he's the son of Secretary of State Colin Powell have made him more compelling than your average FCC head.

What really sets Powell apart is his ability to influence the future of communications at a critical time in history. The FCC chairman will decide

issues that will affect everything from how quickly broadband Net services are rolled out to whether Americans will be able to get video clips on their mobile phones. Top of his agenda: how to free up more radio spectrum for new wireless services and whether cable companies must let Net players use their networks to offer broadband service.

Powell hasn't laid out his positions formally, but he seems likely to

give the Bells and cable companies a fairly free hand. This may mean less competition in broadband services in the short term. To Powell, this kind of hands-off approach will lead to greater innovation and competition in the long run. "[Deregulation] is not a reward for competition, it's an incentive for competition," he says.

Already, Powell has made enemies. His laissez-faire attitude doesn't sit well with consumer groups. And to free up more wireless spectrum, he'll have to pry some loose from the Pentagon or broadcasters. But Powell is the first FCC chairman since the 1970s with a majority of the commission and both houses of Congress behind him. With many battles ahead, he may wish he was a bit more anonymous. •





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LAWRENCE LESSIG

Stanford Law School, Professor

» **CONTRIBUTION:** His first book, *Code and Other Laws of Cyberspace*, challenged what he sees as growing threats to free expression online. His upcoming *The Future of Ideas: The Fate of the Commons in a Connected World* argues that old industries are using Old Economy laws to stifle innovation.

» **CHALLENGE:** To persuade Congress and the courts to adopt laws that balance the rights of old industries with society's interest in encouraging innovation.





visionaries

Stanford Law School Professor Lawrence Lessig is on a losing streak. He sided with the Net music-swapping service Napster Inc. in its doomed court battle against the record companies, which sued for copyright violations. He backed hackers who posted code on the Web that let people duplicate movie DVDs. A court nixed that. And he sided with the government in its antitrust case against Microsoft Corp. The initial ruling to break up Microsoft is expected to be reversed on appeal.

So why is Lessig smiling? Because he predicted this kind of thing would happen. The 39-year-old constitutional lawyer has made his mark as a determined fighter for what he thinks of as a "free" Inter-

net, where sharing of technology and information lets innovators piggyback on each other's work to create an outpouring of economic value. He believes that approach helped turn the Net into an explosive force. He warns it's slipping away.

Lessig's clarion call is at the center of his upcoming book, *The Future of Ideas: The Fate of the Commons in a Connected World*. He argues that legal mistakes, such as overly strong interpretations of intellectual-property law, are strangling innovation. Whether government actively meddles or keeps its hands off, Lessig says, the effects favor established players at the expense of innovators and upstarts. His goal: Laws and court rulings that would promote, and sometimes mandate,

broader licensing of technology. He wants to restructure intellectual-property rules so that ideas are more quickly released into an intellectual commons where others can improve upon them.

Lessig has a strong track record. He successfully pushed for a ruling that forced AOL and Time Warner to open the Time Warner cable system to competitors as a condition of their merger. And the judge heeded him in the Microsoft case. "The fact that elites think Larry understands what he is doing causes judges to turn to him, and it gives him clout," says Cindy Cohn, legal director of the Electronic Frontier Foundation. If Lessig wins points now, the Internet could be "free" for a good while longer. ●



HAL VARIAN

University of California at Berkeley, Dean of the School of Information Management

» **CONTRIBUTION:** Through articles and books, he argues that Net businesses have to adhere to established economic rules. The Priceline.com name-your-price site, for instance, couldn't change consumer behavior.

» **CHALLENGE:** To convince established companies that the end of the Net stock bubble doesn't mean they can ignore changes brought on by the Internet.

Varian, dean of the School of Information Management & Systems at the University of California at Berkeley.

Indeed, Varian has taken a lot of the voodoo out of Net economics. His 1998 book, *Information Rules*, was a primer on how established economics play out in a digital economy. One example: Internet auction site eBay Inc.'s business wasn't actually as novel as some people thought. It's really just electronic classifieds, he says. What made the service more valuable than the Sunday paper was that with many more buyers and sellers available, pricing became incredibly efficient, and the thing snowballed. His lesson: Look for something that has worked in the past and figure out a way to supercharge it using the Net.

While he gained fame for throwing cold water on the Web's excesses, Varian now warns against dismissing it. The work of wringing the benefits out of Internet technology is just beginning, he says, and he urges business leaders to keep at it. When things settle down, this new technology will be as powerful as people thought—just in different ways than they had expected. ●



Academic Hal R. Varian has risen to prominence in the wake of the Internet meltdown based on his simple premise: The past counts. No matter how powerful the Internet is as a tool for communications and commerce, fundamental economics still apply. "My slogan is, you don't need new economics to understand a New Economy," says



innovators

Stripper-turned-singer-turned-actress Courtney Love has made a career out of controversy. Now, she's taking on the record industry in a hotly contested lawsuit that could end up remaking the world of online music.

Love is suing to terminate her contract with Vivendi Universal, arguing that some common practices of the Big Five music labels are illegal. Most important, she contends that record labels are skirting a law that limits contracts to seven years. Record companies often obligate musicians to produce more records than they can complete in that period, essentially forcing an extension. Love, for example, is supposed to deliver five more albums to Universal, even though she has been under contract since 1992. If she succeeds in court, she could set a precedent that would allow hundreds of musicians to walk away from their record labels—and sell more music on the Net.

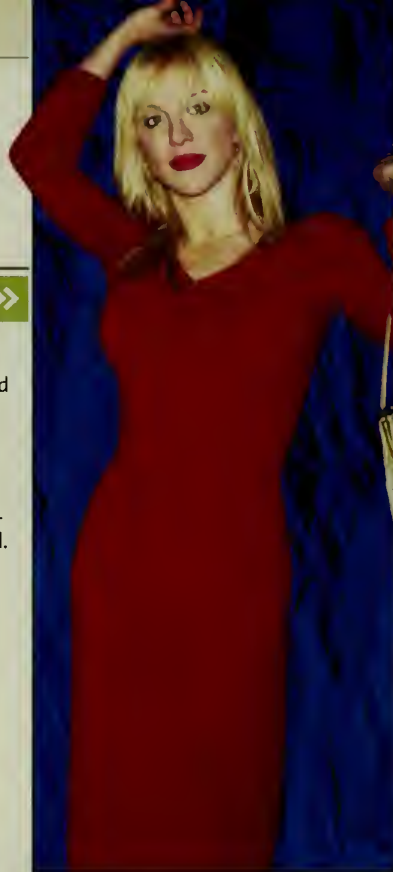
Love, in a sense, is picking up where music-sharing site Napster left off. While Napster got fans used to going to the Web for music, a Love victory would give musicians the control and incentive to distribute their songs over the Web. Rather than letting record companies sell CDs in retail stores and take almost all the money, Love and other artists could cut out record labels, sell directly at lower prices, and reap millions extra. As she sings in one song: “I want to be the girl with the most cake.” ●

COURTNEY LOVE >>

Hole, Lead Vocals and Guitar

>> **CONTRIBUTION:** Love is suing her record label, alleging that many industry practices are illegal. If she wins, hundreds of musicians will have more incentive and control to sell their music on the Net.

>> **CHALLENGE:** If she loses, the record industry could blackball Love and her band.



Roy Ozzie is a shy gearhead who says without remorse that he has almost no life outside his work. His main escape is a 36-foot, modified lobster boat named Reverie, which he takes for jaunts off the Atlantic

coast near his oceanfront home in a Boston suburb. But more often, he's hunkered down over a PC trying to change the world with radical new software.

His product, called Groove, is based on a technology that has the potential to throw gasoline on the Web's now slow-burning fire. So-called peer-to-peer technology uses the Net to link dozens or even thousands of computers, allowing them to share information and files freely. So far, three companies, including GlaxoSmith-Kline PLC and Raytheon

Co., have signed up to try out Groove, which was launched last October.

A ton of entrepreneurs are jumping into the market, but experts believe that if anybody can make P2P a success, it's Ozzie and Groove Networks Inc., his four-year-old Beverly (Mass.) company. He has already proven himself. In the early 1990s, Ozzie worked at Lotus Development Corp. and created Notes, a popular program for group communications.

Ozzie isn't fazed by the competition. “At this point, almost anyone could either be a competitor or an ally,” he says. There's no telling how long his window of opportunity will be open. But you can be sure Ozzie will be spending his time hunkered over a PC. ●

<< RAY OZZIE

Groove Networks Inc., Founder

>> **CONTRIBUTION:** He picks up where Napster left off by bringing to large corporations Groove, a Web groupware program that uses peer-to-peer technology.

>> **CHALLENGE:** To make Groove into a major software company. So far, only a few corporations have signed on to test-drive Groove.





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PAUL BOURKE

Altra Energy Technologies Inc., Chairman and CEO

» **CONTRIBUTION:** He created the first profitable independent online marketplace. More than 240 companies use Altra's online services to buy, sell, and distribute energy.

» **CHALLENGE:** To overcome skepticism about e-marketplaces, he must sign up scads of new customers and maintain profitability.

In the annals of e-commerce, few ideas were more overhyped and disappointing than online marketplaces. That makes Paul Bourke's achievement all the more impressive. As CEO of Houston-based Altra Energy Technologies Inc., the 55-year-old Bourke has overseen the creation of the first profitable independent e-marketplace.

Altra provides a place to sell and buy natural gas, fuels, and electricity. In the first quarter, the privately held Altra oversaw \$8 billion in deals, taking a cut of each. Bourke aims for 2001 revenues of \$65 million and \$100 million by 2002.

With about 10 energy e-marketplaces vying for customers, the business of buying and selling energy on the Net will probably get more cutthroat. But with the steady hand of Bourke, formerly president of financial transactions processor BYSIS Group, it's a good bet that Altra will be the one wielding the knife. ♦



Thanks to Takeshi Natsuno, Japanese wireless carrier NTT DoCoMo has become the No. 1 provider of mobile Web services. It boasts 23 million subscribers for its i-mode service after just 26 months.

Natsuno's approach is a model for others. I-mode subscribers tap into their Net phones for everything from games to music downloads to weather reports. Natsuno, 36, made it a priority to line up quality content providers, which now number 1,700. Fees range from \$1 to \$3 a month per service. DoCoMo gets a 9% cut of these charges and monthly subscription fees of \$3. Revenue from i-mode is expected to reach a huge \$3.5 billion in fiscal 2000.

TAKESHI NATSUNO



NTT DoCoMo Inc., Executive Director, Gateway Business Dept.

» **CONTRIBUTION:** He created the content side of i-mode, Japan's hugely successful service for connecting to the Net via cell phones.

» **CHALLENGE:** To transport i-mode to Europe and the U.S. over the next year and develop new services like shopping for the next-generation phone service, launching on a limited basis in May.

And this is just the start. "All the functions we need—whether it's a watch, wallet, credit card, or Net access—will be built into the cell phone," he predicts. Don't doubt the guru of the mobile Net. ♦

And this is just the start. "All the functions we need—whether it's a watch, wallet, credit card, or Net access—will be built into the cell phone," he predicts. Don't doubt the guru of the mobile Net. ♦



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web smart

Michael Dell was e-business before e-business was cool. During the boom in technology spending, he used the Internet to reach out to customers and sell \$50 million worth of computers a day. That was then. Today, the PC business is in turmoil, and all

the economic indicators show lean times ahead. The party's over for Dell Computer Corp., right?

Hardly. Party on, Michael. Turns out, Dell's returns on e-business may be even more crucial during the downturn. Thanks to efficiencies created, in part, by Dell's Web-based supply chain, the company can remain profitable even

while it launches a bloody PC price war.

In the past year, Dell has hooked 90% of its suppliers into its factory floors via the Web so they can see up-to-the-minute information on orders and replenish Dell's supplies only when necessary. The PC maker reduced inventories to a meager five days' worth last year—down from 13 in 1997—and saved \$50 million. Rival Compaq Computer Corp. had more than three weeks of inventory on hand last quarter. "We don't have to guess what the consumer is going to buy," boasts the 36-year-old Texan.

Now, Dell wants the Web to do a lot more. He's encouraging customers to adopt Web-based procurement systems that can hook directly into Dell's order management system. This produces time savings and gives Dell more insight into its customers' needs. The change cut the average time it took Litton Industries' PRC Inc. to submit an order from 21 days to less than two, and gave the technology contractor an annual savings of more than \$200,000.

Dell doesn't give the Net credit for all of his company's success. "The Web is not a panacea," he says. But the exec's savvy use of the Internet is giving him the edge, while putting the hurt on the competition. Now that's cool. ●



MICHAEL DELL

Dell Computer Corp., Chairman and CEO

>> CONTRIBUTION: He wrote the book on e-business, tapping the Net to do everything from handling customer orders to linking suppliers. The savings have allowed Dell to launch a PC price war—and still be profitable.

>> CHALLENGE: He must find growth in the midst of shrinking PC demand. The trick is to make servers and storage devices so simple that companies will feel comfortable buying them online, cutting Dell's costs.



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When Pradeep Sindhu founded Juniper Networks Inc. in 1996, industry pundits thought he was crazy to take aim at networking powerhouse Cisco Systems Inc. Five years later, Juniper has grabbed 30% of the high-end router market. "What's our secret? Focus and executing relentlessly," says Sindhu, 47.

It doesn't hurt to have an extra ace up your sleeve. For Juniper, that's the Net. The company has built its operations from the ground up to take advantage of the Internet. That enables Sindhu and his colleagues to focus on developing Cisco-killer products—and not get bogged down with the manufacturing, inventory, and other distractions of most metal-bending shops.

The financial payoff has been handsome. Juniper last year enjoyed an eye-popping \$1.02 million in revenue per

PRADEEP SINDHU >>

Juniper Networks, Inc., Founder and Chief Technology Officer

>> **CONTRIBUTION:** Juniper has built itself around the Web. The maker of networking gear collaborates on designs, links with outsourcers, and manages inventory via the Web.

>> **CHALLENGE:** Sindhu must wring all the efficiency he can out of Juniper during the tech slowdown, which is squeezing prices.

employee, vs. \$703,529 for Cisco and about \$400,000 on average for the communications equipment industry. "The Internet is a weapon that cannot be beaten," says Sindhu. This little David has turned into a Goliath in its own right. •



Gary Reiner isn't afraid to pose provocative questions at General Electric Co. "Why do you need a corporate headquarters?" he asks. Broadband networks and new

technologies could make it possible to operate without one some day. "We're clearly much more virtual than we ever were," he tells the troops.

Reiner is spearheading nothing less than a cultural revolution at GE. The goal is to take full advantage of the Internet to sell products and services, to streamline internal operations, and to purchase materials and supplies. GE books only 5% of its sales online now but aims ultimately to hit 30% or more.

Reiner is leading the way for other industrial giants. GE is far ahead of the nation's largest 50 corporations in squeezing benefits out of the Web. Hun-

dreds of GE's Net projects have bloomed. At the locomotive business, for example, engineers developed a Web tool that lets GE hold 100 auctions a day for suppliers to bid on contracts, which could cut purchasing costs by \$600 million this year. Overall, GE expects to ring up \$1.6 billion in cost savings from e-business in 2001.

Reiner gets much of the credit. "What separated him from many other CIOs was that Reiner went out and talked to the different GE divisions and talked to customers," says Richard F. Doherty, founder of Envisioneering Group, a market research firm. "He listened harder to what was working and what wasn't." Maybe Reiner's approach will provoke other major corporations to move more aggressively to the Web. •



<< GARY REINER

General Electric Co., CIO

>> **CONTRIBUTION:** Helped make GE the e-business leader among large manufacturers, with projected savings of \$1.6 billion in 2001.

>> **CHALLENGE:** Pushing cultural change among GE's 340,000 employees and getting customers to buy GE stuff online—everything from mutual funds to jet engine repair services. Last year, GE handled 5% of its sales online, far short of its 30% goal.

"We're working with a new technology — an electronic signature — that makes it possible to do complex transactions electronically. Imagine being able to buy a house and not go to the closing, or purchase a car without having to show up at the DMV to file your registration. That's just the tip of the iceberg."

— Roseanne Lopez, Management Solutions & Services



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Enron Corp. Chief Executive Officer Jeffrey K. Skilling likes to say that the nation's leading energy merchant was ready for the Internet long before there was anything.com. Enron's business of buying and selling commodities such as electricity and natural gas—by phone or fax—was a natural fit for the Web. Over the past year, Enron has taken online trading to a new level, harnessing the Web to bring Enron's risk-management prowess to everything from metals to high-speed communications. "Our volumes are way up," says Skilling.

Try through the roof. EnronOnline handles 5,000 transactions per day. The company posts prices on more than 1,500 products that it stands ready to buy or sell to utilities, municipalities, and other big wholesale customers. Since November, 1999, EnronOnline has traded more than \$525 billion worth of commodities, making it the Web's biggest and most successful business-to-business site.

Skilling's most challenging move: high-speed communications bandwidth. In the

JEFFREY SKILLING

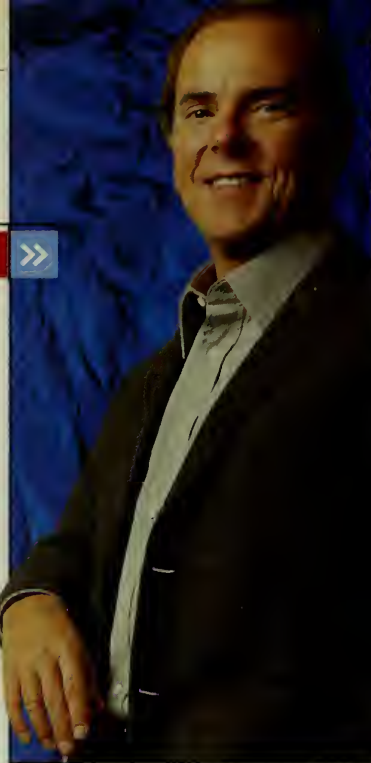
Enron Corp., President and CEO

» **CONTRIBUTION:** Thanks to the Net, he transformed Enron into North America's largest energy marketer. He's trading everything from paper to metals online to the tune of \$162 billion in the first quarter.

» **CHALLENGE:** Get new broadband Internet trading unit on solid footing by proving bandwidth can be traded like a commodity.

past year, Enron has spent \$436 million to create its own 15,000-mile fiber-optic network to provide real-time bandwidth to customers. Because of a supply glut and falling prices, bandwidth trading is struggling. In March, Enron suffered a major blow with the abrupt cancellation of its video-on-demand pact with Blockbuster Inc. Skilling says the deal was called off because Blockbuster wasn't getting movies from Hollywood studios fast enough.

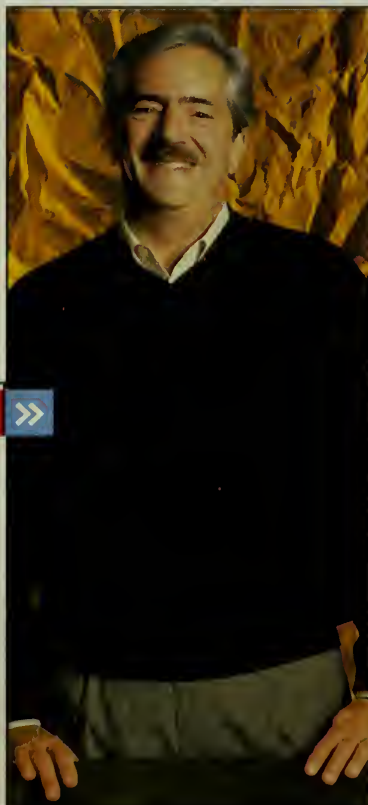
Such setbacks don't faze Skilling, a former McKinsey & Co. consultant who



graduated in the top 5% of his Harvard Business School class. He sees almost no limit to what Enron can trade—even ad space is a possibility. "The Net allows you to touch lots of customers inexpensively," he says. Not bad for mere commodities. •

It used to be that General Mills Inc. had to send researchers across the country to conduct focus groups or hire marketing companies to poll consumers on a new kind of cereal or yet another variety of Hamburger Helper. Now the Minneapolis food company conducts 60% of its consumer research online, reducing costs by 50%.

That's just the frosting on top of General Mills's e-business strategy. The company also makes purchases from Transora,



an electronic-marketplace consortium. And it shares trucking services through an online network—expecting to shave 7% off shipping costs. Not bad for an outfit that traces its history back 135 years to flour mills on the Mississippi.

The man leading this revolution is General Mills Chairman Stephen W. Sanger. The 55-year-old believes the Net is a weapon against eroding margins in the slow-growth food industry. "The Internet gives us capabilities that are beyond anything we have gotten from any other source," says Sanger, who's a model for other traditional industrial giants on how to take advantage of the Web.

Next, Sanger is trying to use the Web to turn marketing into a profit center. He has formed a joint venture with a California market research firm to sell online market research services to other consumer packaged-goods companies. So far, 3M, Nestle, and PepsiCo are among their clients. Thanks to the Web, Sanger is finding a few green clovers in those boxes of Lucky Charms that he makes. •

STEVE SANGER

General Mills Inc., Chairman and CEO

» **CONTRIBUTION:** He made General Mills tops in using the Net to trim costs. The foodmaker conducts research, coordinates logistics, even lets consumers concoct their own cereal recipes—all via the Web.

» **CHALLENGE:** Finding enough savings on the Net to offset slow-growth cereal business. Already, the company stands to save about \$40 million a year on Net logistics.



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on the hot seat

Like many other customers of Amazon.com Inc., ceo Jeffrey P. Bezos keeps a public wish list of Amazon items he might like as gifts. Sorry, someone already bought him the Harry Hairball plush toy he craved. But for \$28.79, gift-

givers can buy him the American Allsafe White Durango Cowboy Hardhat, which meets government safety requirements.

Better make it a rush order, though. No one in e-business today draws more brickbats than the founder of the

world's biggest consumer e-commerce company. Despite \$2.8 billion in sales last year of everything from books to drill bits, Amazon has never earned a penny. That's driven its stock down to \$15—more than 85% below its December, 1999, peak—and put Bezos on the hot seat. If he succeeds, there's hope for e-tailing. If he fails, the promised revolution in online selling may prove a bust. Says director and venture capitalist John Doerr of Kleiner Perkins Caufield & Byers: "He's gone from Internet poster boy to Internet piñata."

Tired of getting knocked around, Bezos for the first time in January promised Amazon would earn an operating profit by yearend. For Bezos, that's a whole new challenge, one he's moving quickly to meet. He has made Amazon more efficient, turning over inventory faster and closing some facilities. Result: Operating losses fell to 7% of sales last quarter, from 17% a year ago. Says analyst Jeetil Patel of Deutsche Banc Alex. Brown: "This is one of the few Internet companies that will end up surviving."

A lot of analysts and investors still have their doubts. And some potential bricks-and-mortar partners Bezos is wooing to join forces on selling low-margin products, such as consumer electronics, are waiting to see if Amazon fades. Says a steely Bezos: "Anybody who's waiting for that is going to be sorely disappointed." But it's likely that more whacks are in store for the Internet's piñata. •

« JEFF BEZOS

Amazon.com Inc., CEO

» **CONTRIBUTION:** Bezos keeps a relentless focus on customer satisfaction, creating a gold standard for other online outfits to meet.

» **CHALLENGE:** What else? Profits! Bezos has promised a quarterly pro forma operating profit by yearend, but it will be tough in a slowing economy.



Martin J. Wygod has always been willing to play the long odds. As a teenager, the New York native gave up his job walking horses at the race-track when he discovered he could make more by betting on the races. Then, in the early 1980s, the stockbroker-by-training took a flier on health care by purchasing a small mail-order pharmacy business—which he later sold to Merck Corp. for \$6.6 billion.

Now CEO of the embattled WebMD Corp., Wygod is betting that he can succeed where others failed—and deliver the elusive payoff from e-health. The goal: Building tight digital links between insurers, doctors, and patients—which analysts say could save at least \$50 billion in processing and other back-office costs. “This is going to happen,” Wygod vows.

So far, though, all WebMD has to show for its efforts is an accumulated \$3.5 billion in losses and a stock that’s down 93% from its peak. But fans say those losses mask the company’s slow but

MARTY WYGOD

WebMD Corp., Chairman and CEO

» **CONTRIBUTION:** By putting WebMD on a steady financial keel and building bridges to doctors and HMOs, he could help revolutionize the health-care system, linking patients, doctors, and insurers to cut bureaucracy and save money.

» **CHALLENGE:** Winning over insurers, who feel threatened by WebMD’s rush to the Web, as well as doctors who are dubious about the Net.

steady progress: It now processes billions of claims and payments and has the most heavily-trafficked consumer health site. Later this year, Wygod will roll out a wireless handheld device to enable doctors to write prescriptions, order lab results, and view patients’ records online. “This is a different company from a year ago,” says S.G. Cowen analyst John Souter. If Wygod, 60, turns WebMD around, his last bet could reap his biggest jackpot yet. •

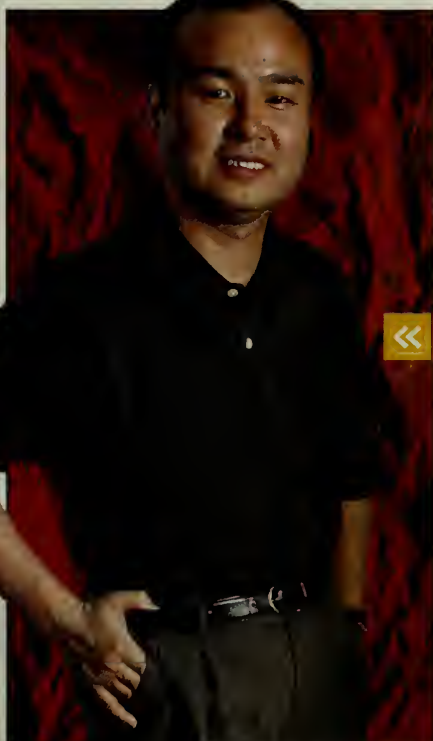


it’s good to be king. And it’s very good to be a king who has cash to play with, despite the global market disenchantment with the Internet. At least, that’s what you will hear from Softbank Corp. founder Masayoshi Son, who is the undisputed ruler of the Net in Japan. The tech meltdown is sweeping away the amateurs, and affords those with staying power a huge opportunity. “I view this as a positive thing,” says Son. “The survivors will now have room to grow.”

Son plans to go full blast, buying into all manner of broadband, wireless, and Internet technologies around the world. On top of \$2.5 billion in venture-capital funds he raised during the fat times, a deal with Cisco Systems Inc. earlier this year put another \$1.05 billion in his pocket.

Softbank aims to add 100 more outfits to its global confederation of 600 upstarts. That makes him one of the last big financial backers of the Internet. While other venture capitalists

are retreating, he remains committed to a vision where the Net transforms nearly all businesses. If he’s right, he could end up being one of the biggest beneficiaries.



Son has taken his share of blows during the downturn. Some \$130 billion worth of Softbank’s market capitalization has been vaporized, and the stock currently hovers at \$38, vs. a split-adjusted high of \$497 reached in February, 2000. Still, his empire isn’t in any danger of facing a cash crunch. “Cash is king, and we have \$3 billion or so” to play with, he says.

In tough times, smart companies find ways to get stronger still. Son looked like a genius when the Net was booming. Now we’ll find out if it was brains—or just the bull market. •

MASAYOSHI SON

Softbank Corp., President and CEO

» **CONTRIBUTION:** Has made Softbank the most aggressive investor in Net startups, with stakes in 600 companies. While other backers retreat, Son plans to invest \$3 billion in some 100 companies.

» **CHALLENGE:** Weather the storm. He must choose which of his portfolio companies to keep stocked with cash, while looking for new winners.

BY ROBERT D. HOF

rob_hof@ebiz.businessweek.com



Survive and Prosper

The bloodied Net companies still standing can now build lasting businesses

I couldn't stifle a smile when Chris Larsen, chief executive of online loan provider E-Loan Inc., recently tried to put the best face on the dot-com meltdown that has knocked his company's stock under \$2—down more than 97% from its high in July, 1999. "If we can get past this," he said brightly, "we can do well because there won't be as much competition." Is it me, or does that sound like someone's whistling past the graveyard?

The thing is, he's also right. If companies have enough funding to stay in business—and granted, that's a mighty big "if" these days—it's actually a whole lot easier to build a company now. It's slower, to be sure. The rocket rides are over. But despite all the dot-com carnage, this may prove the best time to get on with building a lasting business. "Great companies usually come out of recessions stronger," says eBay Inc. CEO Margaret C. Whitman. And I don't think she's whistling, either.

For one thing, now that around nine out of every ten dot-coms has bitten the dust, there is indeed a lot less competition for those still here. The arrival of traditional companies online hasn't filled the void. And even if online retail sales growth slows from the 50%-plus of last year to the 40% that market watcher Forrester Research Inc. expects this year, that's a lot of opportunity for Amazon.com Inc. and others. Goldman, Sachs & Co. analyst Anthony Noto thinks Amazon, for instance, may be the chief recipient of some \$1 billion in online consumer spending this year that had gone to defunct rivals, such as eToys Inc., and struggling ones, such as Buy.com Inc.

At the same time, nobody can spend like dot-com marketing vps on Ecstasy anymore. So the survivors no longer have to fight free services, massive discounts, and multimillion-dollar TV ad campaigns. Notes Jeffrey P. Bezos, CEO of Amazon.com: "If you have a rational business plan and you like your business model, you like to see discipline in the market as a whole."

There's also a growing pool

of talent streaming from the dead.coms. A few months ago, says Tim Tuttle, co-founder of networking technology and service startup Bang Networks Inc., "we could not find a single good résumé." On its Apr. 2 launch day, he was flooded with 2,000 résumés, many "really good." And suddenly, nobody's asking for free cars or huge stock option packages. Says John P. Lewis III, chief people officer for online industrial marketplace FreeMarkets Inc.: "This is a much better market for employers."

Suppliers and landlords aren't so greedy anymore, either. Last year, Kmart Corp.'s online unit, BlueLight.com, had to beg to get suppliers of information-technology services to do work, says BlueLight.com LLC Chief Financial Officer Chris Lien. These days, salespeople for those suppliers are posing as flower delivery people and college students doing papers just so they can get an audience with BlueLight.com's engineering chief. Result: He's paying 30% less for the same engineering and programming work.

Most of all, there's a palpable sense of relief that the boom's unsustainable pace has finally eased. That's leaving a little more time to think past the next financing and the next press release and instead hone the business basics. Drugstore.com Chairman Peter M. Neupert says he can now concentrate less on unending expansion opportunities to support his once-stratospheric stock price and more on running his distribution center with greater efficiency. "I don't know that slower growth is a bad thing," says Neupert.

Of course, even some of the survivors aren't getting enough business. Drugstore.com, Web grocer Webvan Group, and other companies continue to struggle even though they have virtually no online competition left. For all the post-crash advantages, says Stephen Sprinkle, global director of strategy, innovation, and eminence at Deloitte Consulting, "it is an extraordinarily challenging time to be in business." But for those smart enough to survive, the worst of times may well prove to be the best of times. •





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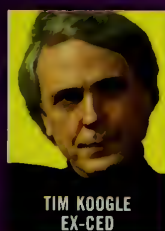
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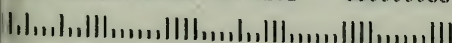


MICHAEL MORITZ
DIRECTOR

BY BEN ELGIN

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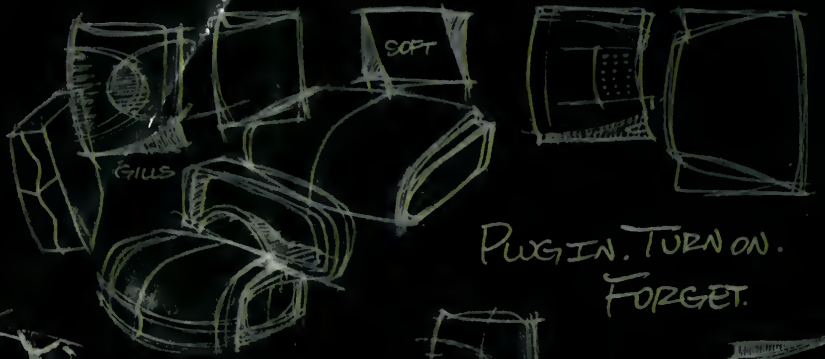
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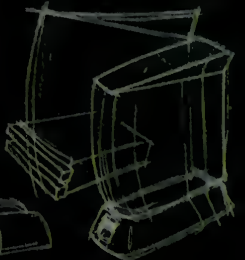
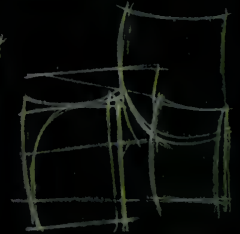
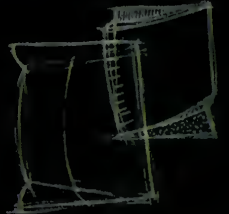


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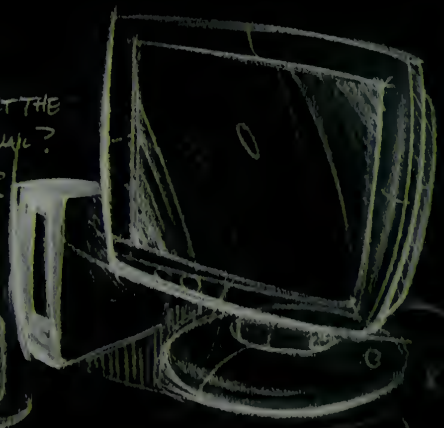
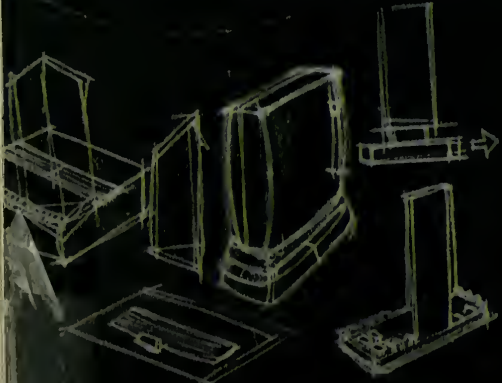
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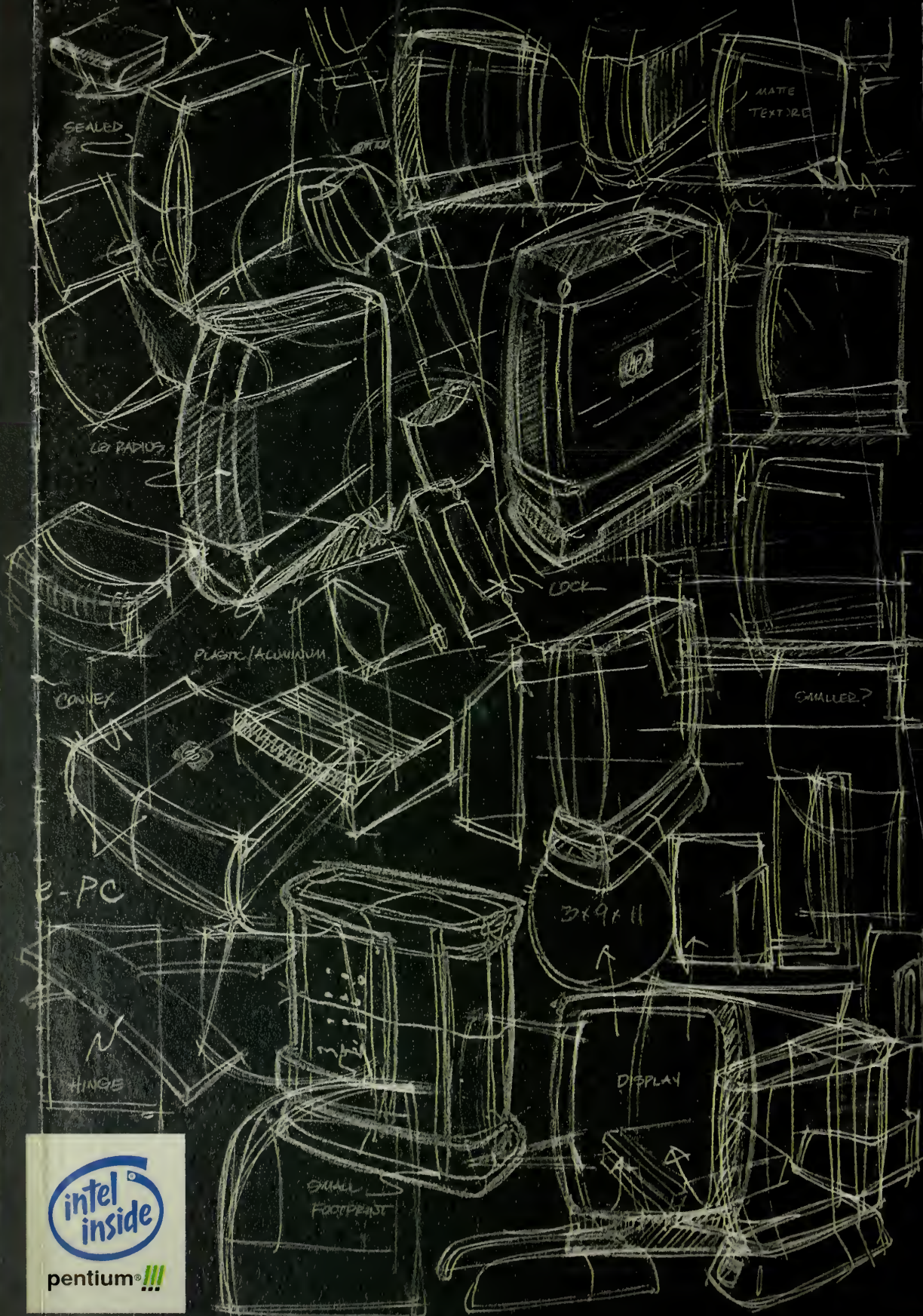
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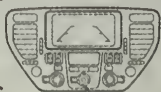


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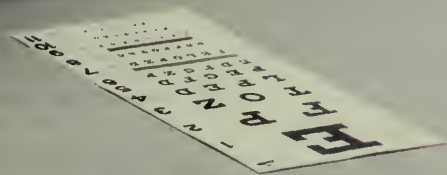
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RECESSION?
Tech's woes and wider layoffs make it more likely page 36



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Cover Story

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In 13 blistering months, a series of blunders have turned Web powerhouse Yahoo into Milquetoast. Here is the untold story of how arrogance and infighting led to the ouster of CEO Tim Koogle and the sidelining of President Jeff Mallett. Now in Koogle's place is Terry Semel, late of Warner Bros. Can he reverse a pattern of deals gone sour, corner-office intrigue, and consensus management in gridlock?

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Pointing North

The yield curve is a pretty good compass for reading the economy's direction—and right now it says better times by yearend



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■ **IM AT WORK:** Companies should embrace instant messaging as a productivity tool, says Accelerator Group's Clay Shirky



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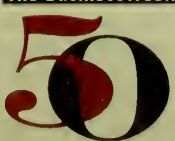


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Up Front

EDITED BY SHERIDAN PRASSO

INDIA INK

A MISGUIDED BEEF WITH McDONALD'S

FOR MONTHS, McDONALD'S HAS been trying to assure Europeans worried about mad and other diseased cows that its

French fries in India are flavored with beef, a violation of Hindu dietary strictures.

The French fry flap follows a U.S. lawsuit May 1 seeking damages for vegetarians who unwittingly consumed a beef extract used to flavor fries in the U.S.—a fact McDonald's now concedes. But company execs stress that fries in India use absolutely no animal products. And Mickey D's 27 outlets there sell no beef, only veggie and lamb burgers.

That didn't stop Hindu nationalists, who trashed outlets after hearing about the suit. A McDonald's spokesman now

says: "It seems the worst is behind us." But with outlets in 120 countries, it's hard to know where the next tempest is brewing. *Michael Arndt*

HOLD THE FRIES or kill the rumor

burgers are safe. But no sooner had sales finally started inching back up than McDonald's got hit by a new scare. The latest? That

TRADE WINDS

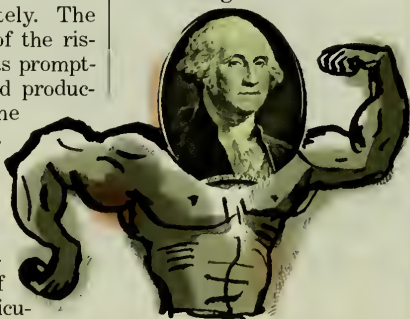
OH, MY ACHING GREENBACK

OH, HOW U.S. MANUFACTURERS have suffered lately. The downturn, on top of the rising trade deficit, has prompted mass layoffs and production cuts. But the industry has kept mum about a principal cause of its woes: the U.S. dollar. A strong greenback has been jacking up the cost of U.S. exports, particularly in Europe and Canada, while making imports cheap.

That silence is about to end. The National Association of Manufacturers will soon begin pressing the Bush Administration to weaken the dollar. NAM says that with the dollar's trade-weighted value up 27% since 1997, it can't compete in many sectors, from paper products to machine tools. Recently, the auto

and aerospace industries have joined the low-dollar chorus.

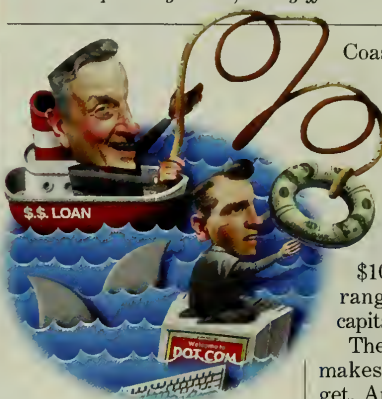
As long as the U.S. economy was humming, industry thought the record-high trade deficit might force a dollar



correction anyway. Since waiting around isn't working, though, NAM officials will urge the Administration to reverse policy and start talking the dollar down. But Treasury Secretary Paul O'Neill, himself an ex-manufacturer, will be a hard sell. After sending mixed signals earlier, O'Neill is now chanting the "strong dollar" mantra of his predecessors. *Paul Magnusson*

TALK SHOW "The U.S. economic slowdown is larger than we and everyone else believed even a few weeks ago"

—Memo to employees from Dell Computer CEO Michael Dell and execs explaining their 4,000 layoffs



TECH TRAVAILS

WHERE TO GO IF THE VC SAYS 'NO'

TECH MAY BE IN THE TANK, but here's a sector profiting from it: venture lending. With equity financing hard to get, more and more early-stage tech companies are turning to such lenders, which charge interest rates of up to 20%. The dozen or so firms nationwide are mostly divisions of specialty finance companies. "When the Nasdaq was soaring and money was easy, companies wouldn't return our calls," says Kathleen Wilkerson, managing director of Third Coast Capital. "Now they are calling us."

Loan volume at Third

Coast, a division of medical equipment financier DVI, has doubled. And business at GATX Ventures, division of a rail-lease firm, is up 50%. Companies generally seek loans of up

\$10 million for purposes ranging from operating capital to tech development.

The risky nature of tech makes these loans hard to get. Applicants must have at least one round of venture capital and proprietary technology. (E-commerce companies lacking patents need n apply.) On top of stiff rates more than double what banks charge—these lenders usually demand the right to buy shares at a set price if the company goes public.

Such loans buy companies time until the climate for initial public offerings improves. "This has given us another quarter," says Howard Bailey, CFO of Nishan Systems, Silicon Valley network-switch maker that's getting its second venture loan, for \$10 million. With Nishan just launching its first product aimed to go public next year, the beauty of a venture loan is that it doesn't dilute company shares. *Robert Bern*

THE LIST CHECK OUT THE E-GROCERIES

Many online e-grocers (Webvan, ShopLink) have foundered. But hold the mayo—there's life in the sector yet. Supermarkets are going e-tail on their own or partnering with dot-coms. Forrester Research predicts e-sales will grow from \$600 million in 2000 to \$7.2 billion in 2005.

ALBERTSON'S

Has offered online service to customers in Seattle since 1999

PUBLIX Plans to launch its own online service in Atlanta this summer



FOODLAND

Honolulu chain lets shoppers pick up online orders at a drive-thru

GIANT, STOP & SHOP

Their Dutch owner, Royal Ahold, acquired Peapod.com and delivers in Connecticut, New York, Chicago, Boston, and metro Washington, D.C.

SAFeway Acquired 50% of GroceryWorks.com which serves four Texas cities

Data: BusinessWeek Online



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BJC-85 Bubble Jet Printer.

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BJC-50 Bubble Jet Printer.

held organizers.* They all deliver stunning 720 x 360 dpi prints at 5 ppm black and 2 ppm color.

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feeder. And just when you think it can't get any better, these compact printers can transform themselves into color scanners with Canon's exclusive, optional IS-12 Color Image Scanner cartridge.**

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Up Front

SECOND ACTS

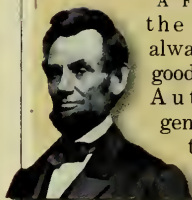
IF YOU FLOP IN BUSINESS, TEACH



J. PETERMAN, THE PURVEYOR OF FLORIDLY written mail-order items aimed at armchair travelers, became a household name after being parodied on *Seinfeld*. In the TV series, his character waxed poetic about clothing and exotic destinations, introducing himself to Elaine by noting her coat's "deep biswing vents, perfect for jumping into a gondola." Yet despite the notoriety, John Peterman's \$75 million business went bankrupt in 1999, shortly after *Seinfeld* went off the air. He lost his 13 retail stores and even his own "J. Peterman" name at bankruptcy auction.

ALLIANCE: *Seinfeld's* O'Hurley and Peterman, new partners

AS THE DOWNTURN TURNS



A. Lincoln

A FLOURISH OF the pen has always been a good investment. Autographs generally retain their value—especially if they are from historical figures.

And never more than now. The Alexander Autographs biannual auction in New York on Apr. 21, one of the largest of the year outside of Sotheby's or Christie's, offered fewer items, thinking sales would be down 10% to 15%. But instead, Nasdaq-wary investors snapped up the old documents, says auctioneer George Hollingsworth. A letter from Theodore Roosevelt sold for \$3,750 after bidding started at \$1,000.

Other ex-Presidents, including Lincoln, also fared well. "I was scared to death going into that auction," says Hollingsworth. "I thought it was going to be all gloom and doom. But now that the market has tanked, our sales skyrocketed."

Now, though, he's back. He's relaunching his business, teaching courses ("Following Your Entrepreneurial Dreams" at New York's Learning Annex), and lecturing MBA students at New York University's Stern School of Business.

What's a failed businessman doing giving advice? "You never really experience anything if you don't fail," explains Peterman, 59, outfitted in his trademark cowboy jacket (\$184) and Australian "Drover's" hat (\$69). "Failing is one of the most important processes of learning." As for his catalog, he has bought back his name and plans to resume publication in June. His e-commerce Web site is now up and running.

And guess who's one of his business partners? The actor John O'Hurley, who played him on *Seinfeld*. Joan Oleck

DRAWN & QUARTERED

CONTINUING HIS CHARM OFFENSIVE, GEORGE W. BUSH VISITS THE ARCTIC NATIONAL WILDLIFE REFUGE TO PASS OUT NICKNAMES...



I-WAY PATROL

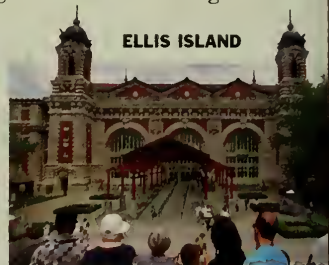
THE HUDDLED MASSES SWARM A WEB SITE

YOU MAY HAVE HEARD THE publicity blitz: A new Web site, ellislandrecords.org, launched on Apr. 17, lets you look up your family immigration records for free.

But if you tried to log on, you probably had trouble. Turns out the huddled masses yearning to find their ancestors have flocked to the site in far greater numbers than it can handle. The Statue of Liberty-Ellis Island Foundation estimates 4 million have managed to get on. But on one recent heavily trafficked day, tracked by Web site performance company Keynote Systems, only 5% of those trying got on.

Ellis has since added 10 servers to its original 13, but

it remains overwhelmed. Site organizers say the traffic abating only slightly. Some 40% of Americans claim an ancestor among the 17 million



ELLIS ISLAND

who immigrated via Ellis Island from 1892 to 1954.

The flocking en masse seems fitting: Apr. 17, 1907 was the most heavily trafficked day at Ellis Island when 11,747 immigrants passed through. Alex Salkev

THE BIG PICTURE

THE WIRED WEST COAST West Coast cities are the most "wired" in the country, with the highest percentage of households with Internet access. The U.S. average is around 56%.

	MAR. '01	MAR. '00
Portland	69.7%	54%
Seattle	69.6%	56%
San Francisco	69%	61%
Boston	68%	52%
San Diego	66%	58%
Washington	65%	56%
Denver	63%	47%

Data: Nielsen/NetRatings



FOOTNOTES Americans who, because of mad cow disease, say they have: stopped eating meat, 6%; not changed their diet, 80%

getting there was easier, would you have more fun
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THE PRESS IS CALIFORNIA DREAMING

How many stories did you run tout-ing Internet dot-commers, multibillion-aire 20-year-olds, and venture capital-ists in the past five years ("The future of California," Cover Story, Apr. 30)? The "latest bubble" was fueled not just by folks in California, those "cowboy VCs," and the Harvard and Stanford MBAs who decided to start companies instead of finishing their degrees. The business press contributed—a lot. Most newbies assumed that "things were different this time" and decided their investment on the assumption that the overvaluations in the public markets would last indefinitely.

Helen Ingerson
San Ramon, Calif.

[To write about California's] problems and economy without a single reference to agriculture is unthinkable. California is the nation's leader in dairy production and ranks high in the production of nuts, grapes, garlic, citrus, and a variety of other fruits and vegetables.

Lee Lindberg
Marco Island, Fla.

Your article implied that the tax-cutting Proposition 13 resulted in cutbacks in California K-12 per-student spending. In fact, using the federal government's National Center for Education Statistics figures, during the 21 years between the passage of Proposition 13 in 1978 and 1999, our per-student spending increased 39% in inflation-adjusted dollars. And

contrary to the graph in your story, of K-12 per-student outlays now almost certainly exceed the national average, using the latest NCES figures and taking into account the extraordinary 8% increase in spending for the 2000-2001 school year.

Alan Bonstetter
President

California Parents for Educational Choice
San Francisco

ATTENTION, GOVERNOR DAVIS

Despite what California's Gray Davis says there were many votes against deregulation in 1996 ("At the mercy of forces that show no mercy," News: Analysis Commentary, Apr. 23), (and many others) voted against deregulation of power companies.

Dotty Foxworth
San Diego

The market is working perfectly. What has failed is the political Establishment and its pathological desire to tinker constantly with the free market. The sooner Governor Davis and the state legislature start working with the market instead of trying to hobble it the sooner the state can get on with encouraging the prosperity for which it has historically been known.

David C. Rod
Pittsburgh

REMEMBRANCE OF THINGS PAST AT AMAZON.COM

In "The company is not the stock" (Information Technology, Apr. 30), Jeffrey P. Bezos of Amazon.com Inc. was

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BusinessWeek
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MAY 21, 2001 (ISSN 0007-7135) *** 3733
 Published weekly, except for one week in January and one in August, by The McGraw-Hill Companies, Inc. Founder: James H. McGraw (1860-1948).
 Executive, Editorial, Circulation and Advertising Offices: The McGraw-Hill Companies Building, 1221 Avenue of the Americas, New York, N.Y. 10020. Telephone 212-512-2000. Telex: McGraw-Hill 270700. U.S. subscription rate: \$41.95 per year; \$79.95 3 years; \$209.50 Single copy/back issues, \$9.95. Call 1-800-268-3647 or email: mcgraw-hill@mcgraw-hill.com. Subscriber Service: 1-800-451-1200. TDD: 1-800-551-1579.
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Readers Report

CORRECTIONS & CLARIFICATIONS

The text of "An oil giant stirs" (International Business, May 7) on PetroChina Co. refers to an \$800 million charge. As correctly noted in the accompanying table, the \$800 million refers to a corporatwide restructuring, not simply the lube-oil unit noted in the text.

"Nursing home care: Code blue" (Social Issues, May 7), which cited varying state reimbursement levels for nursing home care, should have specified that the figures used were Medicare reimbursements.

asked: "Did you originally think of Amazon as just selling books?" Mr. Bezos replied: "It really was just books."

In my (unauthorized) book, *Amazon.com: Get Big Fast*, I quote Nicholas Lovejoy, Amazon.com's employee No. 5, who related a 1995 conversation with Bezos: "Books were always a prelude to other things. At that time, I was doing quite a bit of kayaking. [Jeff] would say: 'In the future, when you come to Amazon.com, I don't want you just to be able to search for "kayak" and find all the books on kayaking.... There should be everything to do with kayaking, and the same is true for anything.' That amazing vision was there then. No doubt about it: Books were just a starting point."

I'm a great admirer of Bezos, but he continues to proffer this fiction.

Robert Specter
Seattle

TRADE TARIFFS DISCRIMINATE AGAINST THE POOR

Rich nations have set tariffs on imports from developing countries at 30% higher than the global average ("Betting on free trade," International Business, Apr. 23). These discriminatory practices are especially common in the agricultural and textile sectors, which are the sources of income for many of the poorest people on earth. A level playing field is a bare minimum if the world's poor are to have any chance of benefiting from increased global trade.

Blaise Salmon
Victoria, B.C.

ONE CHEER FOR TECH'S CHEERLEADER

If you see Mary Meeker's head bowed, don't take it as some sort of tacit admission. She is merely resting

between innings ("Tech's cheerleader won't say die," Information Technology, Apr. 30). The game will be long. It is early. You can rest assured that before we reach the seventh-inning stretch, Mary Meeker will have powered more balls out of the park than Mark McGwire. Way more.

Robert E. Cook
San Mateo, Calif.

PUMPED UP ABOUT PETROLEUM PRICING

"How OPEC's price hikes sap growth" (Editorials, Apr. 9) failed to say that the OPEC nations are sovereign countries and we have no right to demand that they supply all the petroleum they can pump from their property to benefit the American consumer. It is arrogant to expect other countries to let the U.S. dictate policy.

Gerald Foy
Grand Rapids

This cloud may have a silver lining: One or two new energy technologies are close to becoming economically viable. The longer the current prices hold, the more chance these technologies have to get established. Recent advances in solar power and the emerging commercialization of wind power are the most striking examples.

Milan Novacek
Seattle

BIODEGRADABLE CAR PARTS ARE NOTHING NEW

The "Innovations" item on the effort to use *miscanthus*, the bamboo-like grass, to make biodegradable car parts sounded familiar (Developments to Watch, Apr. 30). Way back in 1941, Henry Ford built a whole car with plastic made from sisal, wheat, and (mostly) hemp. The car's ability to absorb impact was many times greater than steel bodies. It was also designed to run on hemp oil.

Eric Rosenbloom
Brooklyn, N.Y.

A HINT TO HELP DRUG COMPANIES PLAN AHEAD

"What's a fair price for drugs?" (Science & Technology, Apr. 30) didn't mention that patent protection covers a relatively short period of the useful production life for a drug. If the period was based on the point at which drugs were brought to market, companies would be able to plan their amortization

much more effectively, because it would be consistent for all drugs.

Aal
San Carlos, Cal

WHAT'S IN A B-SCHOOL NAME?

Since executives in the loftier reaches of American business call each other by their first names, I can see no reason why the latest EMBA's won't be referring to America's latest merged graduate school simply as Harv and Sta ("When Harvard met Stanford," New Analysis & Commentary, Apr. 30).

Richard V. Simo
Newport Beach, Calif.

CORPORATE DIVERSITY AND THE EYE OF THE BEHOLDER

As a stockholder, I believe that the companies I hold benefit from a true diversity of views ("Wanted: More diverse directors," BusinessWeek Investor, Apr. 30). Ms. Gutner's all-too-conventional view of diversity—in gender and racial terms—would not ensure that a variety of viewpoints. For an example that is more symbolic than substantive, how many boards consciously seek members who detest the game of golf?

Ron L. Prombo
Vienna, Va.

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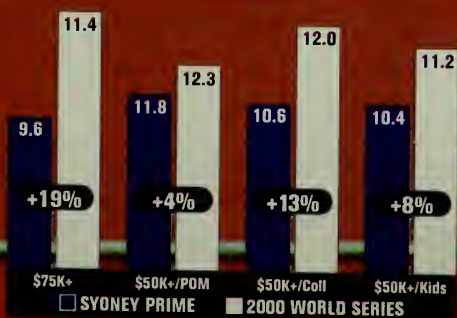
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WASHINGTON
Meg Greenfield
Public Affairs • 241 pp • \$26

PETRI DISH CALLED WASHINGTON

During most of the 1990s, Meg Greenfield, *The Washington Post's* editorial page editor and *Newsweek* columnist, was secretly at work on a book that closely scrutinized makers, bureaucrats, and journalists. The recently published result is called, simply enough, *Washington*. It offers a brutal dissection that would thrill anthropologist Margaret Mead, even though it probably won't find favor with these Washingtonians under her lens. That's not to say that *Washington* is sell-all. After 38 years spent close to the seat of power, Greenfield could have covered some humdingers. But in death—Greenfield died of cancer in 1999—as in life, she's discreet to a fault. She only occasionally names names, and you find yourself yearning for more. Still, Greenfield offers a stimulating analysis of how the national political culture has evolved since 1961, the year she arrived from New York as a 27-year-old to serve as the temporary Washington editor for the now-defunct *Porter* magazine. She had expected to stay just a few months—but never left. By the time of her death, Greenfield felt that the capital, formerly a town where everyone hewed rigidly to its place in the pecking order, had become a colony of lone-wolf operators who viewed policymaking and legislating as a means of marketing themselves rather than as a way to get things done. She found both 1960s Washington and the current scene equally distressing. The author seems most bothered by the fact that Americans view government officials with a resentment bordering on loathing. This is a response, she believes, not to Democrat-vs.-Republican partisanship, but to the way which most elected officials adopt fake personas that conceal their true personalities. The pols, she says, lose all the workings of the region from which they

come, along with family, class, and individual characteristics. Oddly enough, the process is meant to make them more appealing to "the blob," her term for easily manipulated public opinion.

Public distrust is also, in part, the fault of Washington's self-absorbed, regimented "system." This Greenfield persuasively likens to high school, complete with term breaks and hazing rituals. Here, though, every pupil is an over-achieving teacher's pet. Adjusting to the system's taboos and protocols is so time-consuming that most newcomers quickly become wrapped up in the peculiar life of the place and no longer care so much about the folks "out there," Greenfield's term for anything beyond the Washington enclave.

Finally, she says, the public disapproval is due to journalists' relentless pursuit of scandal stories mixed with one-dimensional personality pieces. The media, she believes, too often adhere to an unwritten rule: "Stick to covering the issues and your subjects' carefully crafted image, and avoid any confusing inconsistencies that would make them seem human."

As in pro wrestling, the roles that important Washingtonians play are increasingly scripted, right down to what Greenfield calls the "party skunks." These include curmudgeon journalists such as Charlie Peters of *The Washington Monthly* and liberal muckrakers like Ralph Nader. Her point is valid: One thing that upset loyal Democrats about Nader's Presidential bid last year was that he tossed aside his professional crank's script and tried to grab the leading man's part reserved for Vice-President Al Gore. As for Gore, Greenfield didn't live to comment on his campaign, but surely she would

make him Exhibit A in her chapter on how fake most pols have become.

Whom did Greenfield admire among the many Washington VIPs she covered? Her list is short, but it includes Senator John McCain (R-Ariz.), who had not yet run for President when Greenfield wrote, but whose refreshing candor and irreverent style were already attracting fans. She also names the late Michigan Democrat Philip A. Hart, who served in the Senate from 1958 to 1976, and Kansas Republican Nancy Landon Kassebaum, who retired from the Senate in 1996, as examples of folks who kept their true personalities intact.

It may seem that Greenfield despised Washington's political culture. In fact, she simply sought to understand it. She seems to have concluded what a lot of residents know in their hearts: This can be a brutal, hypercompetitive place where real friendship sometimes seems rare. The elite denizens of this company town spend a lot of time socializing. But even at dinner, there's little diversion, and discussion frequently focuses on that week's major political event.

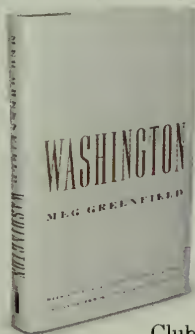
One of the most touching parts of Greenfield's account is her chapter on politicians' wives. Here, she reveals an ambivalence toward the women's movement. When Greenfield first came to Washington, she was not allowed to enter the National Press

Club, even to glance at the news ticker. During interviews, she was sometimes mistaken for a secretary or otherwise patronized by dim-witted lawmakers. But she never adopted the radical feminist perspective that looked down on wives who dutifully accepted the role of Washington hostess. Instead, she recognized the contributions many of them made as conscientious parents and contributors to their communities.

Greenfield helped blaze new trails as a woman journalist by tackling tough subjects, such as nuclear weapons policy, that only men were supposed to debate. In a way, she was the ultimate feminist: She used intellect rather than attitude to compete well in the man's world that is Washington.

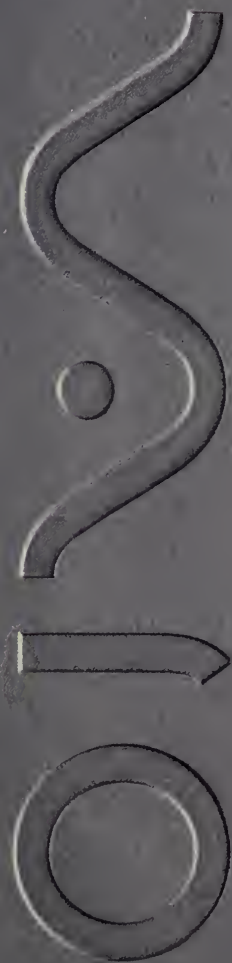
BY PAULA DWYER

Dwyer is deputy manager of the Washington bureau.



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BY STEPHEN H. WILDSTROM

tech&you@businessweek.com

PUTTING E-MAIL IN YOUR POCKET



BlackBerry improves, and now you can get corporate mail to your Palm or PocketPC

As wireless devices proliferate, things can get really frustrating for those of us whose vital corporate information is tucked safely behind fire walls. The one thing we need most—anywhere, anytime access to e-mail—has been the hardest to get. But the situation is getting markedly better.

For the past few years, unless your employer had made the big infrastructure investment needed to provide wireless access, there basically was only one satisfactory way to get to corporate e-mail over a wireless link: Research in Motion's BlackBerry pager. Now, wireless Internet service provider OmniSky (www.omnisky.com) has taken a page from RIM's playbook and is offering BlackBerry-like access to people who use the OmniSky service on Palms and PocketPCs. And Onset Technology (www.onset.com) has tackled another piece of the wireless puzzle, providing a way to get file attachments to BlackBerry's and other devices.

The cleverness of the BlackBerry approach is to make it possible for people to get mail through Microsoft Outlook or Lotus Notes from their desktops—at a price that won't bust an expense account. Typically, the cost is \$400 for the BlackBerry and \$40 a month. "The people most likely to buy these things are spending other folks' money," says David K. Rensin, chief strategy officer of OmniSky. "It's our most important demographic." With the bean counters satisfied, RIM won the hearts of corporate IT departments by designing BlackBerry to provide secure service over existing server systems.

OmniSky has taken a page from the RIM playbook. If you have an OmniSky modem (\$299 and up, with substantial rebates on some versions) and monthly service (\$39.95), you can down-

load the free CorporateLink service, which uses Microsoft Outlook running on a desktop to relay mail from any Microsoft Exchange or standard Internet mail account to your handheld.

CorporateLink, which I tried on a Compaq iPAQ PocketPC, has both advantages and disadvantages compared with BlackBerry. The RIM pager is always on, and messages are quietly downloaded to it one by one. Because of differences in network technology, OmniSky requires you to download your messages manually. While the process is relatively speedy, it's less convenient than BlackBerry's—and makes it much harder to sneak a look at your messages during a tedious meeting. On the other hand, CorporateLink lets you use the considerable capabilities of Outlook's mail-handling system to determine which messages get forwarded to your handheld. BlackBerry's filtering is much cruder.

FRUSTRATING. To offer an alternative to IT managers, OmniSky is partnering with startup ThinAirApps and Wireless Knowledge, a Microsoft-Qualcomm joint venture, to offer server-based mail forwarding. The Wireless Knowledge offering is available now, while ThinAirApps is still in development.

Reading mail on a Palm or PocketPC is generally a more pleasant experience than using a smaller RIM pager. But CorporateLink, like BlackBerry, strips attachments from messages before

forwarding them. This is especially frustrating on PocketPCs, which, unlike Palms, can display formatted Word and Excel files.

Onset's METAMessage offers a workaround. It can deliver the text of attachments to any wireless device for an \$8 monthly service charge. When an attachment-bearing message comes in, you forward it to a special address, and the service sends back a message containing the text extracted from the attachment. How well this works depends on the formatting of the attachment. I tried it on a BlackBerry 957 and found that Word documents generally were readable, though complex features like tables were mangled. Adobe Acrobat files were hit-or-miss. And Excel spreadsheets showed up as a mostly useless jumble. For an extra \$4 a month, the service will direct attachments to a fax for printing in their original format.

As networks and devices improve, so will the ability to get wireless rich-text messages—with graphics and other features. For now, though, CorporateLink is a big help for anyone who wants a BlackBerry-like service on a Palm or PocketPC, while METAMessage is a good first step toward making attachments available anywhere.

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BY ROBERT KUTTNER

KEEP SOCIAL SECURITY AS THE ROCK OF RETIREMENT



HYBRID:
The best approach to retirement would blend portable corporate pensions, Social Security, and tax-sheltered savings

Millions of Americans who have defined contribution retirement plans, such as 401(k)s, suddenly find themselves with a lot less money for retirement, courtesy of the stock market shakeout. The one piece of the retirement package that's rock solid is, of course, Social Security, whose payouts are independent of the stock market and are government-guaranteed. However, this may not last. President Bush has just appointed a new commission to explore the future of Social Security, and most of its members want at least partial privatization, as does the President.

Last month, in this space, I explored three contending principles about how society should provide for retirement. One approach rests primarily on the social insurance inherent in Social Security. The second relies heavily on the corporation. This is a kind of "private welfare state," with the employer in the role of beneficent provider. In the 1950s and '60s, when large corporations and their earnings were stable, an increasing percentage of American employees received generous pensions based on their wage or salary histories and job tenure. The retirement payout was guaranteed by the employer, much the way government guaranteed Social Security.

This type of private retirement coverage is ending fast. Heightened competition and an aging workforce have led corporations to shed pension obligations in favor of optional defined contribution plans, in which the employee takes on the risk for market ups and downs. Unlike traditional corporate pensions and Social Security, these "pensions" can actually run out of money if the retiree lives too long or if the market heads south at the wrong time.

This shift prefigures a third approach, which is increasingly popular in Washington: People should be financially responsible for their own retirement. In this view, it's not a good idea to rely either on a nanny state or a nanny corporation, especially given the new corporate flux and impermanence of employment. Workers, at a young age, should begin putting away money for retirement. They should learn how to become investors. In this third approach, government plays a role by using tax policy to encourage savings, both via individual retirement vehicles—such as IRAs or privatized Social Security—and through tax policy favoring 401(k)s. But that's it. The rest is up to the individual. In this view, everyone becomes a capitalist and accumulates a real nest egg, for retirement, for life's contingencies, and to pass on to children.

It's a seductive argument. But while private retirement savings, invested as prudently or speculatively as the individual wishes, should be part of everyone's planning, they should not be the whole story. Here's why.

First, this third approach largely gets corporations off the hook. In the postwar boom, company-financed retirement plans were, in effect, a substitute for comprehensive tax-supported social insurance. Their erosion has been tantamount to an income shift from workers to corporations and a risk shift from corporations to citizens.

Second, Social Security is a lot more than a government-organized personal-savings program. Unlike 401(k)s or privatized pension schemes, Social Security is deliberately redistributive; lower-income workers get a higher payout than if the formula were mechanically based on lifetime earnings. That's why Social Security is such an effective antipoverty program. Third, you can't outlive Social Security, no matter how many years you collect and no matter the state of the stock market. And fourth, Social Security provides other benefits, such as life insurance and disability coverage. This is the difference between social insurance and privately organized retirement vehicles.

GOOD IDEA. Now, a libertarian might respond that these features all can be purchased from private vendors. But, of course, not everyone can afford them. And no private vendor offers a competitively priced product that includes everything Social Security does. Nor is every new 24-year-old worker sensible and provident.

What society really needs is a balance between these three approaches to retirement. For starters, retain the corporate role. We might mandate that corporations give workers totally portable pensions, with a minimum mandated contribution by the company. Private, tax-sheltered savings vehicles, such as IRAs, are a good idea, too. But these should be seen as add-ons and not substitutes for social insurance. They should not be financed by diverting the current payroll tax that underwrites Social Security.

Diversion of payroll tax to wholly or partly privatized accounts is the course favored most by President Bush and his appointees to the new commission. But, happily, the commission is due to present its report on the eve of the next congressional election. Despite the apparent appeal of privatization and the shifting of risk and reward to the individual, most Americans and their elected representatives still value the stability of Social Security.

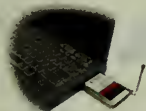
Robert Kuttner is co-editor of *The American Prospect* and author of *Everything for Sale*



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BY GENE KORETZ

REFORM THAT COULD BACKFIRE

Why bankruptcies will increase

Just as bankruptcy reform seems headed for certain passage, the economic omens point to a sharp rise in personal bankruptcies over the next few years. The likely results, says economist Mark M. Zandi of Economy.com Inc., will be "much pain for many hard-pressed households, little if any gain for lenders, and, in the event of even a mild recession, major problems for the overall economy."

If Zandi is right, bankruptcy reform will remain a hot issue in coming years. Backers of the current legislation point

looser lending standards such as subprime and high loan-to-value mortgages—that account for much of this increase and the rise in bankruptcies.

According to a 1998 Federal Reserve survey, nearly one-fifth of families with income under \$50,000 were devoting at least 40% of their aftertax incomes to debt servicing. Data collected by VISA International indicate that more than 40% of bankruptcy filers in 1998 had annual incomes of less than \$25,000, and almost 80% had less than \$50,000.

If looser loan standards lead to higher bankruptcies, why have lenders adopted them? The apparent answer, reports Stavins, is that they also lead to higher profits. Her research on credit-card lenders indicates that banks often profit from attracting risky customers, because such customers don't balk at high fees and interest rates that more than offset losses from charge-offs.

Indeed, Zandi believes tougher bankruptcy laws will simply induce lenders to ease their standards even more. States with the highest bankruptcy rates, he notes, already have stringent wage-garnishment laws, yet net losses to credit-card issuers in such states have been similar to those in states following less restrictive bankruptcy rules.

The drop in bankruptcies in recent years partly reflected the booming economy. But now, with sharply rising unemployment and slowing income gains, Zandi expects high household debt to take its toll. Especially at risk, he believes, are lower-middle-income families, for whom debt repayment dictated by pending bankruptcy reform would entail tremendous hardship.

"If the economy becomes mired in recession or sluggish growth," he warns, "the loss of their spending power could significantly retard a recovery."

A NIFTY SURPLUS SURPRISE?

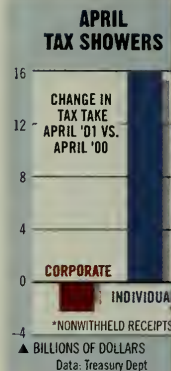
Capital gains still fuel tax revenues

With \$2 trillion in equity wealth destroyed last year, some observers expected capital-gains tax receipts to fall sharply in April. As it turns out, nonwithheld tax payments, which are driven by capital-gains taxes, were up \$15.9 billion or 8.6% over last April's tax take—far outweighing a \$2.2 billion drop in corporate taxes. The increase reflects the fact that many investors sold stocks on which they still had sizable capital gains—and that taxpayers can

only claim \$3,000 in net capital losses in a single year.

Although some forecasters predict that the budget surplus this fiscal year will come in far below the \$281 billion projected by congressional budgeters, those at Salomon Smith Barney Inc. think it could exceed that number. "The tremendous

April surge in nonwithheld taxes," says economist Christopher Wiegand, "eases offsets likely weakness in corporate and individual withholding taxes resulting from a sluggish economy this summer."



TAX-CUT TONIC FOR SMALL BIZ

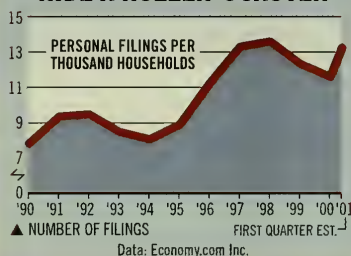
How rate cuts have sparked growth

President Bush's plan to cut the top marginal income tax rate from 39.6% to 33% would aid small business growth, implies a National Bureau of Economic Research study. In the study, researchers Robert Carroll, Douglas Holtz-Eakin, Mark Rider, and Harvey S. Rosen analyzed tax return data to learn how the drop in income tax rates in the Tax Reform Act of 1986 affected the revenues of sole proprietorships—unincorporated businesses owned by single individuals.

Controlling for a number of factors, including any shifts in the tendency to evade taxes by hiding income, the researchers found that the cut in marginal rates boosted proprietors' gross income substantially. According to their calculations, on average each 10% increase in proprietors' aftertax share of profits raised his or her business revenues by about 8.4% between 1985 and 1988. For someone whose marginal tax rate fell from 50% to 33%, that amounts to a huge 28% increase in gross receipts.

To be sure, the study focused on the receipts of businesses that survived in 1988, and small businesses have notoriously high failure rates. But the researchers also found that the shift in marginal taxes had little impact on survivorship rates. The study underscored the large role sole proprietors play in the economy. In 1985, their gross receipts represented some 20% of total U.S. domestic business revenues.

BANKRUPTCIES RIDE A ROLLER-COASTER



to the surge in personal bankruptcies from 7.8 filings per 1000 households in 1990 to 11.6 in 2000 as evidence that more and more people are opting to walk away from debts that they could at least partly pay off. Critics counter that lenders have used credit-card and other solicitations to encourage consumers to take on excessive amounts of debt that force them into bankruptcy when catastrophic events such as divorce, loss of a job, or illness strike.

While the lenders have a point, a study by Joanna Stavins of the Federal Reserve Bank of Boston finds that the rise in personal bankruptcies has roughly mirrored increases in credit-card loans outstanding. And Zandi's research indicates that the shifts in the bankruptcy rate are closely related (with varying lags) to changes in lending standards, the household debt burden, and unemployment insurance claims.

Since bottoming out in 1994, the household debt service level has risen steadily, and it is now back to its prior peak in the mid-1980s. Not surprisingly, it is less affluent households—aided by

JAMES C. COOPER & KATHLEEN MADIGAN

CAN THE NEW ECONOMY PASS THIS SURVIVAL TEST?

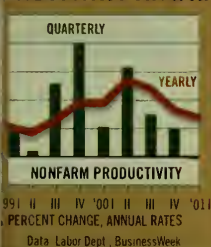
Sharp job losses are a threat, but tax and rate cuts will buoy growth

U.S. ECONOMY

Thanks to slowing demand, falling employment, and sagging productivity, the New Economy finds itself in a precarious position. The test: Can it withstand the heat from the business cycle? The results will say volumes about the long-term outlook for noninflationary growth, monetary policy, and future returns on investments.

The drop in payrolls—a shockingly large 223,000 loss April after a March fall of 53,000—makes it clear that this 10-year expansion faces a perilous time. The losses heighten the risks that the economy is near—even in—a recession. Meanwhile, an unexpected dip in first-quarter productivity coupled with surging unit labor costs mean that corporate profits are getting squeezed as demand slips while labor costs rise.

TWO VIEWS OF PRODUCTIVITY GROWTH



In the short span of a quarter or even a year, cyclical forces cause the economy to gyrate up and down around its longer-term structural trends. Right now, of course, the economy seems to be gyrating only in a downward direction. In fact, the last time payrolls fell as dramatically as they did in March and April was back in the 1990-91 downturn.

But much has changed in the past decade, especially in the last few years. And those shifts, both cyclical and structural, mean that the current labor-market weakness does not necessarily signal that a recession is at hand. However, these changes do imply that the unemployment rate will rise for the rest of 2001, even if the economy avoids a recession.

THREE MAJOR CHANGES

explain what's happening in the labor markets right now. First is the New Economy's dark little secret: In a highly productive economy, business needs fewer workers for any given level of output. For example, over the past year, real gross domestic product grew 2.7%, down sharply from the

5.3% pace in the previous year. But growth in productivity—output per hour worked—held up remarkably well, slowing to 2.8% from 3.8% (chart). Thus, productivity gains accounted for all the economy's growth. So businesses have little need to add to their payrolls, and some are letting workers go.

On the plus side, higher productivity allows a more rapid response by policymakers. It has kept inflation low, enabling the Federal Reserve to slash interest rates. And it has helped to generate the surpluses that make tax cuts possible. Indeed, the Bush tax cut may turn out to be one of the most fortuitously timed fiscal policy actions on record.

To be sure, productivity will sag this year. It fell at a 0.1% annual rate last quarter. But even if productivity does not grow for the rest of 2001, its five-year growth rate will hold at a high 2.4% annually, compared with 1.7% in the previous five years. Plus, as the economy picks up in 2002, productivity will reaccelerate.

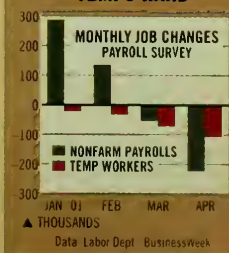
THE SECOND BIG CHANGE

over the past decade is the reaction time of U.S. businesses to changes in demand: As seen with inventories and capital spending—and now labor costs—the adjustment process has been compressed. This has increased the importance of temporary workers who can be hired and fired easily and with less cost. Contingent workers have made the labor markets much more flexible. But in bad times, temps are the first to be let go, as recent data show (chart).

In fact, compared with the last recession, a disproportionately high percentage of recent job losers have been temps, not permanent staffers. During the nine months of the last recession, temp jobs dropped by 88,000, a mere 7% of private-sector losses. In only the past four months, temp jobs have declined by 234,000, while total payrolls have fallen by only 54,000. Excluding temps, who are only 3% of all nonfarm workers, payrolls are up 180,000.

However, many of these temp jobs may not return once the economy picks up, which reflects the third key feature of the economy in 2001: Even though the U.S. can now sustain a lower noninflationary jobless rate than in the past, that rate is a lot closer to 5% than it

LAYOFFS ARE HITTING TEMPS HARD



Business Outlook

is to the expansion low of 3.9%. It was the unsustainable boom in demand in the late 1990s that drew the unemployment rate down to that level, which could not be maintained without giving rise to serious price pressures. And unemployment will continue to rise, as many marginal workers, who were pulled into the labor market by the spending boom, are now cut loose.

THE DANGER: Since consumers have provided the lion's share of economic growth in each of the past three quarters, the weak job markets could be the knockout blow for this expansion. Layoffs could kick consumers' income support away or drive confidence down so far that shoppers just stop spending. ■

But keep in mind that, at a 4.5% jobless rate, labor markets remain relatively tight. That's why pay and benefits are still rising smartly. The Labor Dept.'s productivity report showed that worker compensation grew at an annual rate of 5.2% in the first quarter, and it was up 6% from a year ago (chart). That pace is far faster than inflation, increasing household buying power. In April, average hourly earnings of production workers rose 4.3% from a year ago. Even with the energy-boosted 3% inflation rate, as measured by the consumer price index, real wages are still rising.

A worker's big pay raise, however, is the employer's rising labor cost. In the first quarter, that 5.2% rise in compensation meant unit labor costs jumped at the

same rate, since there was no offset from productivity. And over the past three quarters, unit costs have risen at a 4.3% pace. That's the fastest rate in 10 years and faster than businesses are able to lift prices. That has resulted in the current profit squeeze (page 82).

In an effort to revive productivity and trim costs, businesses are announcing more layoffs. What's uncertain is how much job-market weakness consumers can tolerate. So far, the data suggest only a very soft economy, as businesses adjust to a slower pace of demand. Second-quarter real GDP may even decline.

But that's not a recession. A recession is a unique economic event. It's like a coiled spring that suddenly snaps. The jolt causes an unwinding of economic activity, a weakness that feeds on itself across an array of sectors. The unwinding tends to require two or more quarters of contracting GDP before the forces of growth take over again.

But those growth forces have been especially strong in this expansion, mainly reflecting the economy's evolution during the past decade. Add in aggressive policy action, and the groundwork for stronger growth has already been laid.



CANADA

PATCHES OF SUN IN A COOLING TREND

The Bank of Canada finally capitulated to the obvious. It revised lower its forecast for Canadian growth, citing the slowdown in the U.S. economy.

The BOC's Monetary Policy Report projects that real gross domestic product will grow 2% in 2001. That's down from a forecast of 3% in February and a strong 4% in November, 2000. Growth is expected to be weaker in the first half of 2001, then pick up in the second half. In 2002, real GDP should rise 3%. Soft growth has also been signaled by the index of leading indicators, which has fallen for four straight months (chart).

The policy report said the main

risk to the Canadian economy was that "the U.S. slowdown could be more protracted than anticipated." That would cut export demand from the U.S., Canada's main trading partner.



threat to rise 4.6% this year, according to the Canada Mortgage & Housing Corp. And oil and gas producers are getting a lift from growing energy demand from the U.S. Meanwhile, manufacturers

were less pessimistic in April than they were in January: Fewer expect to cut production in the second quarter than in the first.

Growth should also get a lift from the renewed weakening in the Canadian dollar. It has fallen some 2% since the start of the year. The slide will make Canadian goods more competitive around the world. And it should boost tourism as cash-strapped Americans look for cheaper summer-vacation destinations.

Even so, the BOC's slower outlook ensures that policymakers are not done cutting interest rates. Short-term rates have already fallen by a full percentage point this year. But low inflation, at 2.5% in March, and rate-cutting in the U.S. mean that the BOC has plenty of room to inject some more stimulus into the economy.



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down housing, which is one of the few sectors still driving growth. It used to be that housing starts and sales led a downturn as banks stopped lending and borrowers grew scared. But now, banks know they can sell the loans they make to Fannie Mae or Freddie Mac. And "borrowers use adjustable-rate mortgages with the thought that when interest rates go down, they will refinance," notes Susan M. Wachter, a Wharton School housing economist.

But housing and other construction markets are likely to soften as employment drops, perhaps accentuating the downturn. "Housing is certainly going to be a negative going forward and not a positive," says Kenneth Rosen, a real estate economist at the University of California at Berkeley. He expects a 10% to 20% drop in construction activity starting in the second half of 2001, continuing into 2002.

So why are economists having so much trouble calling a recession? In the early stages of a downturn, the government's data for GDP, consumer spending, and employment typically overstate the economy's strength and are later revised downward. In the last recession, starting in 1990, the government initially reported GDP growth of 1.6% for the third quarter. But by '92, growth for that quarter had been revised below zero; the most current set of revisions shows a -0.7% decline. Real consumer-spending growth, originally reported at 3.6% for the third quarter of 1990, was later revised to 1.5%. And job growth, reported as 0.4%, was revised to -0.5%.

The same downward revisions are likely to happen this time, and for a simple reason: Government statisticians are missing a lot of information when they put out their quarterly and monthly GDP estimates. When the government issued its report on first-quarter GDP and consumer spending, it had data on only slightly more than half of \$4 trillion in consumer spending on services. For the other \$2 trillion, it used informed guesses or, as the Commerce Dept. politely calls them, "judgmental trends." During normal times, those informed guesses are pretty close. But when the economy changes direction—as it does at the start of a recession—they can turn out to be wildly off. More accurate data come in over a couple of years from annual surveys and other sources.

The U.S. could still avoid recession in 2001. But with three months of declining employment on the ledger and more job cuts to come, that doesn't look likely.

By Michael J. Mandel in New York, with bureau reports

THE NEW ECONOMY LIVES ON

The Fed sees the productivity dip as a bump in the road

COMMENTARY

By Rich Miller

No policymaker has studied the inner workings of the New Economy more closely than Alan Greenspan. The Federal Reserve chairman was among the first to recognize in 1995 that the economy was about to embark on a productivity-driven boom. The productivity take-off wasn't visible at first in the official statistics. But Greenspan's own soundings of business leaders and careful reworking of the data convinced him that something momentous was about to happen. So he ignored the warnings of inflation worrywarts at the Fed and kept interest rates low, allowing the New Economy to blossom and

grow far faster than anyone had thought possible.

Now the official data are suggesting that the productivity miracle is about to go up in smoke. In what some analysts saw as a death knell for the New Economy, the Labor Dept. reported on May 1 that worker productivity, or output per hour, fell in the first quarter for the first time in six years. Unit labor costs, the flip side of productivity growth, spiked rising at their fastest rate in three years. New Economy skeptics immediately seized on the data as evidence that the productivity phenomenon was a mere rage pumped up by a stock market bubble that has now gone bust. "These numbers should put to rest the notion that there was a tech-driven miracle in U.S.



ductivity in the last few years," says Shepherdson, chief U.S. economist at Valhalla (N.Y.) consultants High Frequency Economics.

Once again, though, Greenspan isn't saying what the official data seem to be saying. He thinks reports of the demise of the productivity miracle are premature and that tech-led improvements in

corporate efficiency are far from over. Productivity growth accelerated to close

3% per year from 1995 to 2000, roughly double the level of the previous two decades. Greenspan and his fellow monetary mandarins are convinced most, if not all, of that improvement will prove permanent. "We may see weak productivity numbers in some quarterly reports," Chicago Fed President Michael Bosworth said on May 4. "But over the longer term, average productivity growth should continue at relatively high levels."

THE STAKES. A lot is riding on Greenspan & Co. being right. If indeed the slowdown in productivity growth is just a blip, then the economy should be able to shake off its current bout of weakness and resume growing at a 3% pace next year, helped, of course, by generous interest rate cuts by the Fed. But the monetary gurus are wrong, then look out below: The Fed's big dollops of liquidity—including an expected further half percentage point rate cut on May 1—will only serve to pump up inflation by boosting labor costs. The result: an ugly stagflationary brew of weak growth and rising inflation.

Fortunately, the odds of the Fed getting it right are pretty good. There's plenty of evidence to support the view that the underlying, or trend, rate of productivity growth is still high—and likely to remain so. For starters, productivity slipped last quarter mainly because of a statistical anomaly involving self-employed people whose

hours worked soared after declining sharply in the final three months of last year.

Over the past year, productivity has grown 2.8%, about in line with the boom time gains.

Productivity numbers, moreover, tend to jump

around a lot from quarter to quarter, and even from year to year, in response to the ebbs and flows of the economy. What's important for the long-term health of the economy is not these temporary ups and downs in productivity but its underlying rate. Even in the golden economic era of the 1960s, when productivity growth also averaged close to 3% annually, it still swung wildly

from year to year. In 1969, for instance, productivity was mostly flat as growth slowed from close to 5% the previous year to 3%. But because the underlying rate stayed strong, it quickly recovered, averaging an annual 3% the following four years.

There's good reason to believe the same sorts of swings are occurring now. Chris Varvares, president of St. Louis consultants Macroeconomic Advisers, reckons that about 90% of the deterioration in productivity growth from more than 3% last year to zero today can be explained by cyclical, transitory factors. "The first-quarter numbers are not inconsistent with trend-productivity growth between 2½% and 2¾%," he says.

The steep rise in unemployment over the last six months, to 4.5% in April, seems to back that up, says J.P. Morgan Securities Senior Economist James Glassman. In the past, such a big jump in unemployment only occurred when the economy was in a recession. But growth over the past six months has averaged about 1.5%. That's exceedingly modest by New Economy standards, yet in line with the average that prevailed from 1973 to the mid-1990s. The ability of companies to pare their payrolls so aggressively while still meeting the demands generated by a growing economy suggests that the productivity of the workers they're retaining is high.

Of course, companies have not only been cutting back on workers, they have also been trimming investment. If taken too far, that could crimp structural-productivity growth. But economists say the cutbacks would have to

be a lot sharper than they have been to date to put a big dent in productivity. Why? Because the level of investment is still sky-high by historical standards, even after the recent cutbacks. In the first quarter, for instance, companies invested the equivalent of \$539 billion annually in information-processing equipment and software, according to government figures. While that was some \$20 billion lower than the fourth quarter, it was still far higher than the \$433 billion actually invested in all of 1999. Those outlays are boosting the economy's capital stock and making it more efficient.

PRICES SLASHED. Thanks to a steep fall in high-tech prices, the companies that are continuing to invest are getting more for their money. Faced with a sharp slowdown in demand, tech companies have slashed prices in a bid to move unwanted inventory. Computer prices in the first quarter plunged at a 28.5% annual rate, the biggest drop in almost three years.

That's bad for the bottom line of computer and other high-tech companies, but good for their customers and the economy.

All that high-tech investment has enabled companies to retool and boost efficiency. And the process has just begun. A survey released on May 1 by the National Association of Purchasing Management found that some

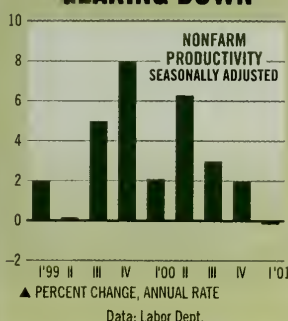
three-quarters of purchasing executives at manufacturing and nonmanufacturing businesses believe that they can still wring significant efficiencies by applying technology to the way they carry out their business.

That's the sort of on-the-factory-floor intelligence that Greenspan loves to collect. And it's helping to convince him that, despite the naysayers, the New Economy is alive and well.

Miller covers the Fed in Washington.

THE ECONOMY

GEARING DOWN



STILL ON TRACK

Greenspan believes technology-led gains in efficiency are far from over

COMMENTARY

By Christopher H. Schmitt

A HANDICAPPER'S GUIDE TO THE NEW SEC CHIEF

Bush Administration officials pass up few opportunities to extol the virtue of the nation's growing investor class. And why not? The fact that half of U.S. households now own equities is seen as vindication of former President Ronald Reagan's belief in "the magic of the marketplace."

But all the democratization of investing has also exposed investors to an array of abuses as Wall Street's second-class players. Now, with the selection of a savvy Wall Street insider as chairman of the Securities & Exchange Commission, comes an important test of just how serious the Bush folks are. Will Harvey L. Pitt, a Washington (D.C.) securities lawyer with a roster of clients ranging from Wall Street finagler Ivan Boesky to the Big Board, continue the energetic defense of individual investors championed by outgoing SEC head Arthur Levitt Jr.?

SWIFT RISE. Those who know Pitt insist he has the talent to head the agency. From 1975 to 1978, he was its general counsel, capping a swift seven-year rise at the agency. Since then, he has been a securities litigation superstar whose nomination has won bipartisan praise.

The morning line on Pitt is this: He's expected to be an energetic and vigilant chairman, in the tradition of Levitt. But most believe he'll lack his predecessor's appetite for public jawboning and backroom pressure tactics. "The commission will continue to be activist," ventures John F. Olson, a securities lawyer who has known Pitt for years. "But there will be more of a cordial give-and-take with the industries it regulates."

As a legal hired gun, Pitt hasn't left much of a philosophical record on many of the thorny issues that mat-

ter to individual investors. So, to determine if the new chief is a Wall Street patsy or a Pitt bull, investors should follow these bellwether issues:

■ **Regulation FD.** A recent Levitt legacy, it bars companies from selectively and preemptively sharing information before its public release. Reg FD is detested by the securities

tions about whether investors have been getting the best deals on trades. Previously, Pitt drafted a plan, first embraced but then dropped by the SEC, that would have centralized trading among his then-clients, some of the biggest investment banks. Now, Pitt will need to look beyond vested interests and ensure that investors get the best prices.

■ **Regulatory overhaul.** On Capitol Hill, Senate Banking Committee Chairman Phil Gramm (R-Tex.) is beginning a sweeping review of decades-old laws that underpin the workings and oversight of the nation's security markets. Financial giants are eager to roll back rules. Key for investors: Will Pitt fight

his old allies to preserve protections in the face of industry-streamlining efforts?

■ **Circular dealing.** Acting SEC chair Laura S. Unger recently took up a longstanding issue: the conflict created when securities ana-

lysts use their research to curry favor with companies in hopes of landing investment-banking business for their firm. Already she has called for better disclosure, changes in analysts' compensation to play down incentives for them to be involved in banking, and stronger patrols of the all-but-collapsed division between firms' analysts and dealmakers. A pro-investor SEC chief will throw his weight behind such a drive.

Certainly, the new chairman's actions may not always be so black and white. But these tests will give investors a clear view on whether Pitt is emerging as an advocate for investors, or investment firms.

With Mike McNamee and Paula Dwyer, in Washington, D.C.



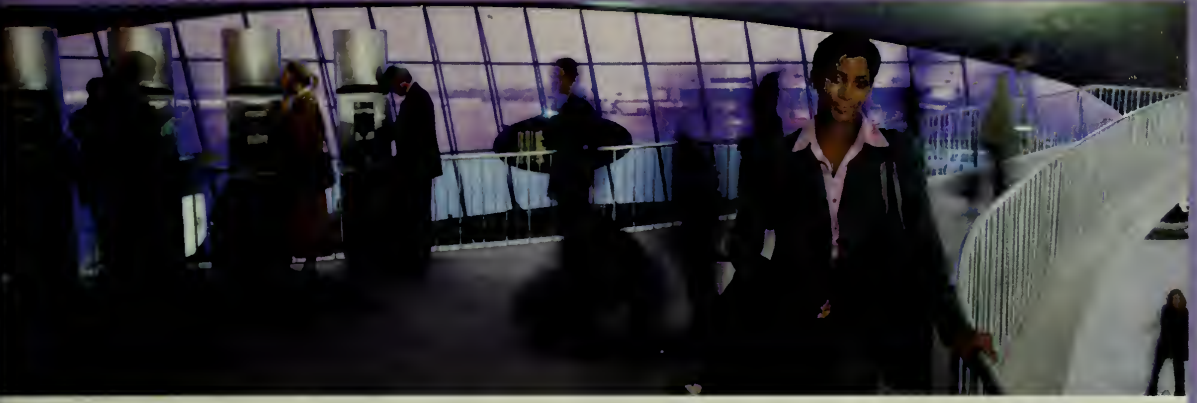
“The [SEC] will continue to be activist. But there will be more of a cordial give-and-take with industry”

— JOHN F. OLSON, securities lawyer

industry, which is preparing a new assault. Some of Pitt's former clients are among those who'd like it weakened. If the new chairman wants to level the playing field for small investors, watch to see that he doesn't countenance any rollback of Reg FD.

■ **Creative accounting.** To boost profits, companies have been tартing-up their earnings statements as never before. These approaches range from omitting or redefining traditional expenses. With enforcement cases expected soon, an activist SEC head won't temper the agency's enthusiasm for referring such cases to the U.S. attorney's office.

■ **Market structure.** New electronic trading systems have raised ques-



MANAGEMENT CRISIS

Roberta hears about
client crisis on way to
meeting in Tucson.
She goes back to office.
She misses her flight.
She misses her meeting.

CRISIS MANAGEMENT

Roberta hears about
client crisis on way to
meeting in Tucson.
She wirelessly accesses
crucial information from
company intranet.
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NETWORKING

WHY CISCO'S COMEBACK PLAN IS A LONG SHOT

Even if the economy revives, the company faces fierce rivals

If ever a corporate rocket needed a boost, it is Cisco Systems Inc. In a conference call on May 8, the company reported its first year-over-year sales drop since it went public in 1990. Even after a massive \$2.2 billion write-down of excess parts, swollen inventory at the networking-gear maker grew 60%. It has fired thousands of workers, the first layoffs in its 17-year history. As many of its New Economy customers—dot-coms, Web hosters, and upstart content providers—go belly-up, they're taking large chunks of Cisco's business and most of its growth with them. Instead of the 50% to 60% annual sales and profit growth that CEO John T. Chambers predicted as late as December, 2000, Cisco will post growth of less than 20% for its fiscal year ending in July.

To hear Chambers tell it in the conference call, a turnaround plan is already in place. Chambers reiterated to skeptical analysts that Cisco will return to its historic growth rate of 30 percent to 50 percent over the next 3 to 5 years. To get there, Cisco will exit laggard businesses and focus its investment in areas with the potential for highest growth, such as broadband equipment and Internet-based phone systems. Management will also cut \$1 billion in costs this year on top of the layoff of 18 percent of its workforce. While it will still acquire upstarts, it will buy fewer companies and only later in their product life cycle. "We're in a stronger position relative to our peers than we were six months ago," Chambers told *BusinessWeek*.

EXPERIENCE NEEDED. Perhaps. Yet Chambers' plan relies on three assumptions that were once taken for granted but are now shaky at best: that Cisco can execute its restructuring, that its markets will rebound to historic growth levels, and that Cisco will get more than its fair share when they do.

Start with the restructuring. Cisco's management may lack the experience needed for such a task. With Chambers spread thin—he spends half his time with customers and travels three days a

week—he'll need help. Yet Cisco has no chief operating officer, and only a few Cisco managers, not to mention other workers, have turnaround experience.

Chambers is counting on his decentralized management style to help the plan succeed. But that philosophy served Cisco poorly during the last six months. The company was doubling its inventory, hiring workers, and acquiring companies

CEO CHAMBERS IS SPREAD THIN



at a record clip just before the biggest falloff in demand Cisco has ever experienced. Now, Chambers is asking these same employees—most of whom have watched their options sink underwater in the past 12 months—to work harder to turn the company around.

Even if Cisco's internal changes go smoothly, its markets aren't likely to accommodate his vision. Customers, such as WinStar Communications and NorthPoint Communications Group Inc., that contributed 20% of Cisco's revenues in the second half of 2000 are disappearing through bankruptcy. And according to the company itself, its dot-com business could fall to less than 2%, whereas it was expected to double, to near 10% of its total. Cisco insists it will find new customers, but analysts are skeptical. "Cisco is in denial about how it will replace this business," says Scott C. Cleland of research provider Precursor Group.

Moreover, with upstart rivals vanishing, the large corporations that make up 65% of Cisco's business are feeling less pressure to update their networks. Meanwhile, big phone companies are expected to spend 8% less on equipment this year, according to Lehman Bros. Wall Street analysts now peg annual growth of the corporate networking market at 10% to 15%. "They'd have to hit the cover of the ball in the service-provider market just to get to 20% to 30% overall growth," says Martin Pyykkonen, an analyst at C.E. Unterberg, Towbin.

DWARFED. And there's no guarantee that Cisco will get the lion's share of growth. It faces fierce competition in its fastest growing and most profitable market. Last year, in high-end Net routers, Juniper Networks Inc. doubled its share

WHAT COULD BLOCK A TURNAROUND

- ▶ Telecom and dot-com customers are disappearing
- ▶ The corporate market, 65% of Cisco's sales, will grow only 15% to 20%, down from a high of 30% in recent years
- ▶ The IT spending slowdown is spreading to Europe and Asia—more than half of Cisco's business
- ▶ Phone companies' capital outlays could fall 10% or more this year
- ▶ Cisco is losing market share to Juniper Networks in the lucrative router market

of the market, to 34%—while Cisco's share fell from 78% to 65%. And even though Cisco sold more than \$1 billion worth of optical products last year, those sales, and its product line, are dwarfed by rival Nortel Networks Corp. Ciena Corp. has also beaten Cisco to several fast-growing niches of the optical market. To catch up, Cisco could acquire companies. Yet with its stock severely depressed, that's less likely.

It's clear that Chambers intends to manage Cisco with a strategy similar to what he has used since becoming CEO in 1995. He says investors expect him to take risks, and he will continue to do so. "If a plane gets into trouble, pilots are taught that you have to get aggressive as soon as possible," says Chambers. That may be true, but no amount of risk-taking may be able to save Cisco from some low-altitude flying.

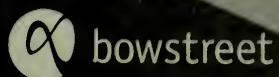
By John Shinal in San Jose, Cal

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CHA-CHING.



COMMENTARY

By Cliff Edwards

SORRY, STEVE: HERE'S WHY IT WON'T WORK

For years, Apple Computer CEO Steven P. Jobs has tried working with retailers to make shopping for Apple's stylish products as appealing as using them—everything from setting up kiosks to special sections adorned with Apple's Think Different posters. Still, the computer maker's share has fallen, and Jobs figures he knows why. "Buying a car is no longer the worst purchasing experience. Buying a computer is now No. 1," he griped at the MacWorld trade show in January.

Now, he's taking matters into his own hands. On May 19, Apple will open a swanky new retail store—the first of as many 110 nation-

wide—at Tyson's Corner Galleria mall outside Washington. While Apple execs won't comment on their plans, the idea seems clear: Well-trained Apple salespeople in posh Apple stores can convince would-be buyers of the Mac's unique advantages, including its well-regarded iMovie software for making home videos and its iTunes program for burning custom CDs.

"CAVIAR." With its top-notch brand and proven marketing panache, Apple should have a shot at improving on the Gateway Country Store model. And it will give Apple fresh outlets to sell its own products such as the titanium PowerBook and other companies' consumer gadgets such as Handspring Inc.'s Visor handheld line. The company would gain new revenue as a reseller of other electronic goodies and have more control over marketing and servicing of its products. What's more, Apple could boost margins by cutting out mid-

dlemen and wooing buyers to higher-priced models.

The way Jobs sees it, the stores look to be a sure thing. But even if they attain a measure of success, few outsiders think new stores, no matter how well-conceived, will get Apple back on the

hot-growth path. Jobs's focus on selling just a few consumer Macs has helped boost profits, but it is keeping Apple from exploring potential new markets. And his perfectionist attention to details has resulted in beautiful but pricey products with limited appeal outside the faithful: Apple's market share is at 2.8%. "Apple's problem is it still believes the way to grow is serving caviar in a world that seems pretty content with cheese and crackers," gripes former Chief Financial Officer Joseph Gruber.

Rather than unveil a Velveeta strategy, Jobs thinks he can do a better job by experienced retailers at moving the ga. Problem is, the numbers don't add up. Given the decision to set up shop in rent districts in Manhattan, Boston, Chicago, and Jobs's hometown of Palo Alto, Calif., the leases for Apple's stores could cost \$1.2 million a year each, says David A. Goldstein, president of retail

researcher Chartwell Marketing Co. Since PC retailers' gross margins are normally 10% or less, Apple would have to sell \$2 million a year per store to pay for the rent. Gateway doesn't pay \$8 million a year at each of its 100 Country Store locations. Then there's the cost of construction, hiring experienced staff. "I give them two years before they're turning out lights on a very painful expensive mistake," says Goldstein.

Harsh words. Still, Jobs is instinct that Apple has to take some dramatic steps is on target. In recent years, Apple has succeeded mainly by getting its 25 million-strong customer base to upgrade pricier machines with higher margins. But only 12 million of them are due for upgrades in the next couple of years, analysts estimate. Meantime, Dell Computer Corp. and Compaq Computer Co. have been stealing share from Apple in the key education market.

New stores aren't going to fix Apple's sales

1997
\$7.081
BILLION

2001
\$5.8
BILLION
EST.

...s more, Apple's retail thrust
...e one step forward, two steps
...terms of getting Macs in front of
...ers. Since most Mac fans already
...here to buy, much of the sales
...ple's stores could come out of
...s of existing Mac dealers. That
...ring its already damaged rela-
...ith partners to new lows. In ear-
...Best Buy Co. dropped the iMac
...er refusing a Jobs edict that it
...light colors. Sears, Roebuck &
...last year dumped Apple, sources
...er concluding that sales were too
...iss. And in recent weeks, Mac-
...ains such as The Computer Store
...mputerWare have closed down,
...weak margins. Now, faced with
...tion from Apple, others may cut

back. "When you choose
to compete with your re-
tailers, clearly that's not a
comfortable situation,"
says CompUSA Chief Op-
erating Officer Lawrence
N. Mondry.

Indeed, rather than
taking on the retailers
who ought to be its
partners, Apple would
do better improving how
it works with them. A good step would
be to end the "think secret" approach
that shrouds every new-product an-
nouncement. Covert operations worked
beautifully when Jobs first arrived on the
scene; his charismatic stage presence and
Apple's eye-popping designs created



TOO PRICEY: The G4 PowerBook

priceless buzz. Now, re-
tailers complain that the
secrecy prevents them
from doing advance ad-
vertising to hype sales
and clear out inventory.
"They are the most secre-
tive company I've ever
done business with,"
says one top retailer.
"They should let the
news leak out, to con-

vince the world how exciting their stuff
is. That's how everyone else does it."
Maybe it's time Steve Jobs stopped
thinking quite so differently.

*Edwards covers Apple from
San Mateo, Calif.*

APPLE AND GAP: HOW COZY IS TOO COZY?

...ne of the big no-no's
...e corporate gover-
...crowd: interlocking
...memberships, in which
...s from two compa-
...on each other's

Why? Governance
...es worry that it can
...cozy relationships in
...directors look out
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...e is not to
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...rships," says
...inow, editor of
...orporate Li-
...a governance
...e. "There's
...a closed loop."

RELATIONSHIP? That's why some
...are bothered by what's been go-
...between Apple Computer Inc.
...p Inc. Back in May, 1999, Gap
...lard S. "Mickey" Drexler joined
...board. Four months later, Apple
...ven P. Jobs joined Gap's board.
...ere are arguments for the ap-
...ents, given Apple's move into re-
...and Gap's interest in Jobs's
...s as a consumer marketer. But
...the potential for problems, gover-
...nks argue that if Apple really
...retail exec on its board, it
...turn to someone with no compa-
... "There's an obvious conflict,"
...rew Hambly, senior analyst at In-
...Responsibility Research Center
...ington. It creates "a 'you scratch



CEO DREXLER



CONFLICT? Gap is linked with Apple's rollout

my back, I'll scratch yours' perception."

Indeed, the relationship raises ques-
tions surrounding Apple's hiring of the
retail contractor Fisher Development
Inc. to build Apple stores. To procure
sites for its new chain, Apple hired
Gap's former head of real estate,
George W. Blankenship. No problem
there. But to actually build stores, Gap
brought in Fisher. The contractor's
chairman is 69-year-old Robert Fisher,
brother of current Gap chairman and
founder Donald G. Fisher, age 72.
Fisher Development has long had a re-
lationship with Gap. Over the past 25
years, the San Francisco builder—one
of the nation's biggest—has overseen
some \$3 billion in projects for Gap, and
it derives more than two-thirds of its
revenue from the clothing retailer, ac-
cording to the trade publication *Shop-*

ping Center World. Although
Fisher is a respected contrac-
tor, that relationship has long
been scrutinized by
governance experts
because of the po-
tential conflicts in-
herent in choosing
the chairman's broth-
er for such signifi-
cant deals.

Jobs, Drexler, and
Donald Fisher all de-
clined to comment, and
Robert Fisher could not be
reached. And no one is sug-
gesting that Apple, Gap, or
Fisher have done anything il-
legal. But for corporate gov-
ernance experts, the question

is how Apple shareholders can be as-
sured that Fisher won the contract be-
cause it offered the best deal rather
than because it is owned by an associ-
ate of a director. "They need to hold
the business relationship to a higher
standard to avoid at least the percep-
tion of a sweetheart deal," says Ted
White, director of corporate governance
for pension fund giant California Public
Employees' Retirement System, which
owns both Gap and Apple stock.

At minimum, experts say, Apple
should fully disclose details of the com-
panies' dealings in forthcoming Securi-
ties and Exchange Commission filings.
But they would be better off to end the
relationship altogether.

*By Douglas Robson in
San Mateo, Calif.*



FOUNDER FISHER

TELEVISION

BRACING FOR RUPERT'S SATELLITE ATTACK

Cable companies gear up before News Corp. buys DirecTV

To fellow media moguls, Rupert Murdoch is like one of Steven Spielberg's dinosaurs. The ground starts shaking even before he shows up. That's why some of cable television's largest players swung into action in early May, after General Motors Corp. acknowledged it was negotiating with Murdoch's News Corp. to sell him GM's controlling stake in its fast-growing DirecTV satellite service. Just days later, Cablevision Systems Corp. dramatically geared up its rollout of digital services and said it will spend \$1.7 billion to offer video-on-demand and other digital services to compete with satellite TV. Other cable executives have been out campaigning on behalf of their industry, too, making the case that cable service still outperforms satellite. "Rupert should try to get all the market share he can quickly because we like the hand we've got," says Cox Communications chief executive James O. Robins.

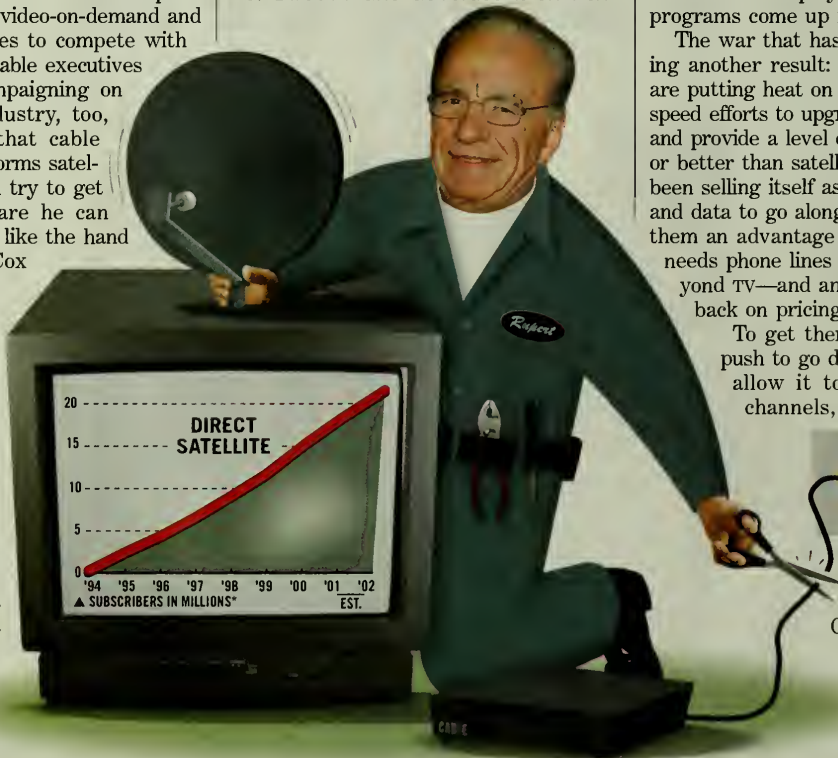
Murdoch is still weeks away from striking a deal to merge DirecTV with his own far-flung satellite assets in Britain, Asia, and Latin America. But the U.S. cable industry has reason to worry. Already, small-dish satellite TV has eaten steadily into its market share. Since DirecTV was launched in 1994, it and satellite rival EchoStar Communications Corp. have grabbed 15.4 million subscribers. While still small compared to cable's 69 million, satellite is growing at a sizzling 18% annual rate.

Now, the cable industry sees an even greater threat in Murdoch's likely entry into their market. Feared in the media world as a merciless competitor, Murdoch in the past has taken losses to win eyeballs, as he did in 1994 when his

Fox network outbid CBS to air National Football League games. This time around, cable operators worry, Murdoch will slash prices for satellite service and import offerings that have already proved successful at his BSkyB service in Great Britain. "Rupert is cable's worst nightmare," says Larry Haverty,

GRABBING EYEBALLS

Expect Murdoch to lower the price of DirecTV and advertise it on Fox



a vice-president at State Street Research, which owns 11 million shares of Hughes Electronics Corp., the GM unit that owns DirecTV. "They haven't seen competition like they'll see now."

Murdoch isn't commenting. But the News Corp. chairman has said privately he wants to at least double DirecTV's nearly 10 million subscribers, giving him the mass audience he needs to launch new channels. To cut costs, he's likely to

use Fox to advertise DirecTV, and drop the costs of set-top boxes by ordering mass quantities for all his satellite assets. The cost cuts will allow him to bid for more channels and to offer set-top boxes to consumers for free, he does with BSkyB. Currently, DirecTV customers buy their boxes.

BALANCING ACT. A smart strategy, except for one thing: If he gets DirecTV and makes such moves, Murdoch would be walking an uneasy line, both competing with cable and supplying it with programming. Cable operators paid News Corp. \$1 billion in the past nine months to show his Fox channels, which earned \$107 million, a 43% increase. And once he has DirecTV, Murdoch will likely import channels for it that compete with cable, such as one that allows sports fans to choose their own camera angles. That, combined with lower prices, could convince cable to play hardball when Fox programs come up for renewal.

The war that has yet to begin is having another result: Murdoch's ambitions are putting heat on the cable industry to speed efforts to upgrade its own offerings and provide a level of service comparable or better than satellite. The industry has been selling itself as a "bundler" of voice and data to go along with TV. That gives them an advantage over satellite, which needs phone lines to offer anything beyond TV—and an opportunity to fight back on pricing.

To get there, cable is in a mad push to go digital, which will allow it to offer hundreds of channels, a crisper picture,

and interactive programming guides. By late this year, the industry will have 14.6 million digital subscribers, projected by Goldman, Sachs & Co. analyst Richard J. Rosenstone. That would trail the combined number of DirecTV and EchoStar

making some cable guys vulnerable, figures UBS Warburg analyst Thomas Eagan. Among the weaker players are AT&T, which inherited several poor systems when it bought Tele Communications Inc., and Cablevision, which has been late to roll out digital boxes. And when Murdoch shows up, that's when the ground will really start shaking.

By Ronald Grover in Los Angeles
with Tom Lowry in New York



Awakenings No. 4

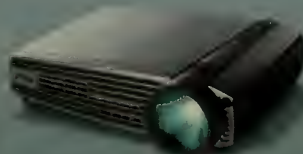
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CREDIT CARDS

CONGRATULATIONS, GRADS —YOU'RE BANKRUPT

A marketing blitz buries kids in plastic and debt

Katy Spivak, a student at Emory University in Atlanta, will never forget the first credit card she signed up for, as a freshman in the fall of 1997. "I thought, 'Wow, here's \$500 in free money,'" recalls the psychology major. One card quickly became 14, and within three years, Spivak ran up \$9,000 in debt, charging everything from pizza to clothes. "I put \$3,000 alone on my credit cards during a trip to Italy last summer," she says. Today, the 22-year-old senior still owes \$7,500 and works two part-time jobs to pay off her bills.

Spivak is among tens of thousands of students overwhelmed by ballooning credit-card debt. An alarming number are now filing for bankruptcy. "The first big act of too many young people as adults was to declare themselves financial failures," says Harvard University law professor Elizabeth Warren, who released a study on the trend last year.

Just how financially delinquent are today's teens and college students? According to Warren's study, bankruptcy filings by those 25 and younger rose 51% during the 1990s. From 60,180 in 1991, the number leapt to 118,000 by 1999. Now, the 25-and-under set accounts for 7% of the nation's bankruptcy filings.

"CAN'T WIN." Blame the phenomenon on a free-flowing credit spigot aimed directly toward a whole lot of kids without the maturity to keep spending under control. In its latest annual study of student borrowers, college-loan giant Nellie Mae found that the percentage of college students with four or more cards hit 32% in 2000. Since 1998, the

average student's debt from plastic jumped 46%, to \$2,748, while nearly 1 in 10 owed more than \$7,000.

Why the big rise? Since the mid-1990s, as the adult market has matured, credit-card issuers have increasingly targeted college students. Their lack of jobs notwithstanding, students have disposable income and are initially, at least, debt free. They're also an easy mark, won over with incentives such as T-shirts, coffee mugs, concert tickets, and round-trip airline tickets. Even better for companies that make their money on interest payments, students tend to borrow up

to the limit and pay only the monthly charges. "The banks are looking for marginal borrowers," says Warren.

But credit-card companies insist that offering cards to young adults is not only a good business, it's good for the kids. "Truth is, many members of the industry are involved in educating students about managing money," says Catherine Cummings, vice-president of consumer affairs at MasterCard International Inc. Cummings cites an industry-funded pilot program begun last year on 15 campuses that employs students to educate their peers in money management.

For their part, some college adminis-

trators admit they have done a poor job teaching students home economics. "We tell coeds, 'Don't go home late at night,' but nothing about the dangers of credit," says Lewis Mandell, dean of the management school at the State University of New York at Buffalo. Mandell also points out that university administrators often give credit-card companies access to their students because issuers frequently underwrite campus activities. Credit-card giant MBNA Corp., for example, has financed an alumni-student mentoring program at the University of Ottawa.

KEEP OUT. Now, a backlash seems to be brewing. Democrats just tried unsuccessfully to add a provision to the consumer bankruptcy bill currently before Congress that would have prevented the marketing of credit cards to anyone under age 18. Meanwhile, campus administrators are cracking down on their own. Colleges ranging from New York's SUNY Buffalo to Georgia Tech in Atlanta have banned credit-card marketers from the campus.

Such efforts remain limited, however. For the foreseeable future, most students aren't likely to have any trouble getting extra credit at school.

By Charles Haddad, with Ushma Patel in Atlanta, Nicole St. Pierre in Washington, and bureau reports



LICENSE TO SPEND: Katy Spivak and her cards



GENERATION I.O.U.

- 95% of all college students and 32% of high schoolers had credit cards in 2000.
- University students with four or more credit cards rose to 32% by 2000.
- From 1998 to 2000, the typical student's credit-card balance grew 46%, to \$2,748.
- 10% of students with credit cards owe more than \$7,000. 25% owe more than \$3,000.

Data: USA Education Inc., Experian Information Solutions Inc.

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In Business This Week

EDITED BY MONICA ROMAN

NORTHROP GRUMMAN MAKES WAVES

WILL NORTHROP GRUMMAN'S hostile, \$2.1 billion cash-and-stock bid for Newport News Shipbuilding on May 8 upend General Dynamics' friendly, all-cash offer for the same amount? It depends on how the Bush Administration answers some broad policy questions about the defense industry's health. Los Angeles-based Northrop Grumman gripes that the General Dynamics deal would let GD monopolize nuclear shipbuilding capabilities. General Dynamics, based in Falls Church, Va., contends there isn't enough demand for more than one nuclear shipbuilder, and the military could save billions from consolidation. In choosing savings or competition, the Pentagon may have

to forgo the help of two top officials with potential conflicts of interest: Navy Secretary-designate Gordon England, a former GD executive, and Air Force Secretary-designate James Roche, a Northrop Grumman exec.

REFINERS GET PUMPED UP

ALTHOUGH GAS PRICES ARE soaring, refiners seem more interested in buying one another than in adding capacity. On May 7, Valero Energy announced plans to acquire its San Antonio neighbor, Ultramar Diamond Shamrock, for \$3.9 billion. It would become the nation's second-biggest refiner after Exxon Mobil. Just three months ago, Phillips Petroleum agreed to buy Tosco, the biggest independent U.S. refiner. Valero Chairman and CEO William Greehey says he expects trustbusters' approval because the companies' operations don't overlap much, and their combined bulk would help them get cheaper crude oil, lowering prices for consumers.

NEW BOSSES FOR B-SCHOOL RIVALS

TWO OF THE TOP BUSINESS schools in the U.S.—both based in metro Chicago—have new deans. The University of Chicago on May 8 named Edward Snyder dean of its graduate B-school, a day after crosstown rival Northwestern University elevated Associate Dean Dipak Jain to head its Kellogg Graduate School of Management. Jain, 43, a marketing professor at Kellogg, replaces Donald Jacobs, who retired after 26 years at the helm. Chicago's Snyder, 47, who takes over from Robert Hamada, had been dean of the University of Virginia's Darden School.

HEADLINER: ANDREW LACK

PRIME TIME FOR AN NBC NEWSHOUND

ANDREW LACK IS JOINING that rarefied club of newsies who ascend to the top of TV networks. In an announcement that surprised some in the broadcasting industry, NBC said on May 8 that Lack, president of its news division, will become president of the entire network.

The 53-year-old former documentary producer will assume the role from Robert Wright, who will remain CEO of NBC but spend more time at parent company General Electric. Wright will be assisting Jeffrey Immelt as he gets ready to take on the Her-

culean task of filling the shoes of legendary GE CEO Jack Welch.

Lack's appointment might just signal that Welch is now ready to cut short what had already been a prolonged exit after GE's pending bid for Honeywell. That

means Immelt might take the helm by summer's end rather than at the end of the year, GE insiders say.

As for Lack, NBC is hoping he can do for its sagging prime-time lineup what he did for the No. 1-rated *Today* show and *NBC Nightly News* with Tom Brokaw.

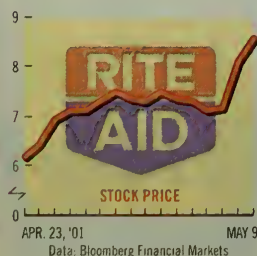
Tom Lowry



CLOSING BELL

RECOVERY

Rite Aid shares surged 13%, to \$8.10, on May 8 after the struggling drugstore chain reported a smaller-than-expected fiscal fourth-quarter loss. Investors were buoyed, analysts say, because the results indicate that Rite Aid can easily meet its hefty debt obligations. Indeed, on May 9, credit-rating agency Standard & Poor's changed its outlook on Rite Aid bonds from negative to positive, and the stock moved up another 5.4%, to \$8.54.



CIENA: NOT AN OPTICAL ILLUSION

CHALK UP ANOTHER WIN FOR Ciena, a small Linthicum (Md.)-based maker of optical networking products that has been gaining ground against optical giant Nortel Networks. On May 8, Ciena said that it snagged a two-year deal valued at more than \$150 million to supply optical switching and transport systems to TyCom. The Bermuda-based carrier will use Ciena's products to build an undersea optical network that will link six continents.

and 9.5% from March—to an average \$1,825 per vehicle. Sport utilities, minivans, and pickups had the best deal, averaging nearly \$2,000 per vehicle. While great for buyers, it will hurt carmaker profit margins. It used to be that only domestic auto companies offered rebates on low-cost financing options. But in April, Japanese brands sharply pumped up their incentives, with help from a weak yen. Forced to keep up with the incentives, Detroit's Big Three are in for a painful period of lower earnings.

DETROIT'S DISENCHANTED APRIL

AUTO MAKERS HAD A DISAPPOINTING April, with industry sales down 10%. But it wasn't for lack of trying. Rebates and other incentives jumped 11.4% from the year before—

ET CETERA...

- California regulators want to raise industrial electricity rates as much as 50%.
- J&J has offered \$1.3 billion for Inverness Medical's diabetes-care business.
- Merrill Lynch will cut its investment management workforce by 20%, to 3,600.



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EDITED BY PAULA DWYER

GREENSPAN VS. THE BANKS: IS A REMATCH IN THE MAKING?

Two years ago, as Congress was considering the repeal of Depression-era rules that walled off banking, insurance, and securities from one another, Federal Reserve Chairman Alan Greenspan warned that letting banks make big investments in other companies could put the deposit insurance fund at risk. That won him some safeguards when Congress approved almost unfettered merchant banking, in which banks take venture-capital-style stakes in everything from the corner store to high-tech startups.

But Greenspan and other federal banking regulators haven't given up the fight. Now, they're trying to force banks to offset the risks of merchant banking by boosting the capital they keep in reserve. The regulators, led by Fed Governor Laurence H. Meyer, also want to limit banks' role in managing companies in which they hold large stakes.

Unhappy with what they see as a regulatory straitjacket, banking execs are asking Congress to force their overseers to back off. The struggle could lead to a reopening of the landmark Gramm-Leach-Bliley financial-services act of 1999. "It's a major battle," says Robert J. Abel, a Washington attorney representing a coalition of banks. "A lot of people feel that now the merchant banking issue turns out will largely determine how well the [act] works."

HOWLS. Before 1999, banks had been able to make only limited merchant banking investments. The new law allows them to own up to 100% of a company. The merchant banking unit of Wells Fargo & Co., for example, wants to step up investments in management buyouts and international communications ventures, says John P. Whaley, a partner in Wells Fargo's Norwest Equity Partners. But a Fed proposal to boost reserves—as much as 25¢ for every dollar of merchant banking investment—puts banks at a competitive disadvantage, he says. The Fed initially proposed a 50¢-on-

the-dollar requirement, which drew howls. Bank execs insist that other safeguards, such as a requirement to isolate merchant banking activities in a subsidiary, make additional reserves unnecessary.

Merchant banking's risk to the bank insurance fund is distant, but not zero. Under the new law, banks and their merchant banking siblings share the same parent. If the merchant bank suffers losses, the holding company might have to shore it up. That, in turn, could cripple its ability to support the bank if it, too, runs into trouble. The result: a drain on the insurance fund.

Unable to persuade regulators to back down, the banking lobby is turning to Capitol Hill. There, it has three influential allies: Michael G. Oxley (R-Ohio), chairman of the House Financial Services Committee; Richard H. Baker (R-La.), head of the capital markets subcommittee; and Spencer Bachus (R-Ala.), head of the financial institutions subcommittee.

Clearly, the GOP leaders are ideologically aligned with the bankers, but generous campaign contributions probably haven't hurt. The financial-services sector supplied the biggest chunk of campaign cash to the 2000 reelection efforts of Oxley, Baker, and Bachus. Commercial banks in particular were the No. 1 bankrollers of Baker and Bachus, giving them \$107,550 and \$95,700, respectively.

Any measure introduced in Congress would likely reduce capital requirements and ease restrictions such as the ban on cross-marketing between banks and companies in which they invest. House Republicans seem willing to consider a bill, and the industry coalition is prepared to push it. But attempts to water down the rules could raise the ire of consumer groups and resurrect the decade-long fight to overhaul financial services that Washington thought it finally settled.

By Christopher H. Schmitt, with Laura Cohn



ENFORCER: Raise reserves

CAPITAL WRAPUP

BLACK VOTER BACKLASH?

► In an important reversal of voter turnout patterns, blacks are now more likely to vote than whites, according to what both groups told a bipartisan Battleground 2002 Poll. In fact, African Americans are far more enthusiastic about voting than are Protestant fundamentalist whites, a key component in the Republican electoral base. Since black support for the Democratic Party is at an all-time high, that could be good news for Dems in hotly contested 2002 Senate elections in Arkansas, Louisiana,

Georgia, and the Carolinas, as well as 2001 gubernatorial races in New Jersey and Virginia. Why the change? Blacks continue to be angry about alleged voter intimidation in Florida during the last Presidential election.

GREEN CONSERVATIVES

► Vice-President Dick Cheney's controversial energy plan has been under attack by Democrats and environmentalists for weeks. But now the plan is angering some Congressional Republicans, too. The energy report, expected

in mid-May, is likely to call for additional drilling on public lands, expanded use of coal and nuclear power, and less onerous rules for building pipelines, electricity transmission lines, and refineries. But in an early May meeting with Cheney, about 16 members of California's Republican delegation. California Republicans criticized the draft plan for focusing too much on boosting the supply of energy and not enough on conservation and energy efficiency. The GOP lawmakers told Cheney that the report won't pass muster in Congress without some changes.



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As debt-ridden rivals wilt, Chris Gent's Vodafone booms

The battle raged for a decade in Britain, but both sides were fighting for far larger stakes—the claim to an empire. As the contest drew to a close, the two chiefs hewed to a time-honored script, dispatching emissaries to hammer out the terms of surrender of one side to the other. First came the bankers, taxiing through April downpours in the City of London. Then came the lawyers. And finally, on Apr. 30, when the details were settled, Vodafone Group PLC's Christopher C. Gent met with the boss of his debt-ridden rival, British Telecommunications PLC's Sir Peter Bonfield. Giving him an IOU for \$5.3 billion, Gent laid claim to BT's portion of the jewel they previously shared, Japan Telecom Co. and its mobile subsidiary, J-Phone.

So now, Chris Gent, the most voracious raider in the wireless world, plants his flag deeper in Japan, the leading country for the mobile Internet. There he faces the titan of the wireless Web, NTT DoCoMo. But a greater sign of Gent's sway than his victory over BT

or his rising stature in Japan is the spell he casts over financial markets. Three days after closing the Japan deal and a related takeover in Spain, Gent's team moved to finance both pieces with an equity offering. The timing could hardly have been worse. Investors, worried about the exploding costs and tarnished promises of the mobile Net, have been fleeing the telcos for months. Yet for Gent, raising \$5 billion took all of a morning. Yawn.

A FROLIC. Talk about waltzing through a wake! Much of the telephone industry, suffering the shocks of the dot-com collapse and a monstrous debt splurge, is paring investments and auctioning off treasures in a bid to survive. BT is a prime example. Yet Gent frolics ahead of this forced march, raising billions between an English breakfast and his usual lunch-on-the-run. In down markets or up, investors love a winner. And Vodafone, with its clean balance sheet and global reach, has that golden glow. As Gent's beleaguered competitors shrink, he has Vodafone on an expansion

track. The goal—nothing fancy—is to become the world's dominant phone business. "Vodafone is better positioned than any other company," Gent says.

He's racing to put together the pieces; and in doing so, he's orbiting the globe nearly as fast as space tourists Dennis Tito. With the Japan deal, Gent now owns a 45% stake in Japan's No. 1 operator, a joint venture with Verizon Wireless Inc. that covers the U.S., leadership across Europe, and holding around the rest of the world, from Egypt and South Africa to Mexico. Vodafone currently boasts 89 million wireless customers in 29 countries.

No other phone company comes close. Yet Gent still lacks operating control in key markets, including the U.S., Japan and France. And if you think he's going to bulk up simply by shopping the telecom fire sales, reconsider: When opportunity calls, Gent doesn't hesitate to launch attacks. He'll even fire his financial guns at his partners. Just ask the former high-flying CEO of Mannesmann, Klaus Esser. Through most of 1999, he

was Gent's partner in Germany, Italy, and France—Vodafone's bulwark on the Continent. But by early 2000, after Gent's \$183 billion hostile takeover, it was Gent who ruled the Continent, and Esser was gone.

Esser's story should give pause to Gent's current partners, Verizon Chairman Charles R. Lee and Vivendi Universal's Jean-Marie Messier. Says John Tysoe, head of global telecom research at WestLB Panmure in London: "In time, Vodafone would like to control the Verizon business in the U.S." If Verizon, with its \$60 billion in debt, runs into trouble funding third-generation wireless networks, deep-pocketed Gent could step in—and win control of the North American operations for himself.

Gent has raced to an early lead, and he still benefits from two advantages. First, his is the only pure wireless play. This gives him more focus and higher growth than his often-disaffected competitors. Second, he went global in a hurry. Two and a half years ago, before his competitors tuned in to the coming wireless land grab, he outbid all Atlantic Corp. for AirTouch Communications Inc. And he paid the price, \$3 billion, in Vodafone stock.

Stock is the currency Gent has used to build his empire. Sure, it has taken a hit in the tech meltdown. Vodafone shares have fallen by 45% from the 12-month high. Yet Vodafone's market value remains a lofty \$191 billion, leaving Gent's company ahead of Nokia Corp. as Europe's most valuable technology business. What's more, while competitors like France Télécom and Deutsche Telekom have gone on acquisition binges of their own, doubts about their stock

have often forced them to pay in cash. This has left France Télécom with debt topping \$60 billion, far more than Vodafone's \$14 billion. The result: While the others watch their credit ratings sink, Vodafone maintains its stellar A standing—a vital edge in a down economy, where the ability to raise cash is crucial. "Everyone else has to pick and choose what they do," says Niklas Savander, vice-president for mobile applications at Nokia. "Only Chris Gent can afford to do it all."

WEAK SPOT. Even Gent's Achilles' heel, his backwardness on the Web, barely dents the company during this tech downturn. The market, newly disdainful of dot-com investments, applauds Vodafone's bread-and-butter virtue: its ability to generate cash flow from the voice business. Sales, including revenue from all of its investments, are expected to grow from last year's \$33.15 billion, to \$42.9 billion this year—93% of it from mobile yakking, according to UBS Warburg. And it is projected to rake in \$7.2 billion in net income in the year ended in March, growing to \$10.3 billion this year.

Gent's numbers are the envy of the industry. But should he stumble, the 53-year-old Gent risks following in the footsteps of another raider, WorldCom's Bernard J. Ebbers. The parallels between the two are uncanny. Like Gent, a commoner in a British industry dominated by knights, Ebbers angled at bluebloods from his base in rural Mississippi. Ebbers, too, used his rich stock to piece together a behemoth. But in the end, his empire delivered little more than commodity capacity—empty tubes for other companies' content and services. Now, WorldCom's stock has fallen by 70%, and the company has the whiff of takeover bait.

Gent can ill afford to repeat Ebbers' mistakes. To make sure he doesn't, he must take his eye off the takeover game and shore up Vodafone's weak points. First, he has to unite Vodafone's new holdings, from Germany's Mannesmann

to Japan's J-Phone, into a cohesive company. At the same time, he must race to assemble a winning Internet offering, one that will bring in new revenues as the price of voice calls tumbles. The goal, says Gent, is to jack up data revenues from the current 7% to between 20% and 25% of sales by 2004. "We're on track to achieve that," he says.

His confidence is disarming. Yet, a year after its birth, Gent's Internet venture with Vivendi, Vizzavi, remains a dwarf on the Net with barely a half million registered users. "They're not even on the radar screen," says Carsten Schmidt, an analyst at Forrester Research Inc. The other phone companies have leading Internet services for desktops, while Vizzavi is tied to mobile and digital-TV offerings that are still in diapers. Gent's edge is that his rising stake in J-Phone, which competes against

powerful NTT DoCoMo in Japan's booming mobile market, could provide his group with a crash course on the mobile Net.

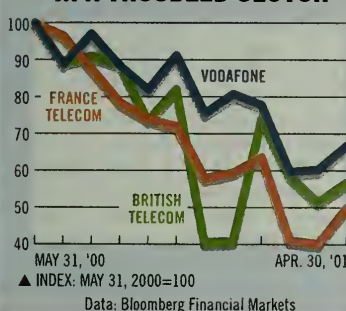
While Gent takes his Web lessons in Japan, he'll be calling the shots elsewhere. He's using his bulk to bully suppliers for the coming high-speed mobile Net. Vodafone is first in line

for scarce handsets for the high-speed data system, known as 2.5G, that's already rolling out across Asia and Europe. He's the biggest phone buyer in the world, purchasing \$3 billion of handsets this year alone. That gives him leverage to bargain down phonemakers, including Nokia, on price.

Gent doesn't need to raise his voice or drop his habitual smile to rob his partners of a good night's sleep. Sure, he's likely to stay cordial with the folks at Verizon and Vivendi—until the day he decides a minority stake is not enough. It's that acquisitive nature of his, after all, that has Chris Gent licking his chops as the rest of the industry falters. His fun makes it that much more painful for everyone else.

By Stephen Baker in Paris and Kerry Capell in London

VODAFONE: TOP DOG IN A TROUBLED SECTOR



Vodafone's \$191 billion market cap puts it ahead of Nokia as Europe's most valuable technology company

SEA CHANGE ON CHINA

The Bush team takes a hard line

Two years ago, U.S. Defense Secretary Donald H. Rumsfeld—then chairman of Gilead Sciences Inc.—visited a museum in Beijing set up to celebrate the 50th anniversary of the Communist takeover of China. On the archway at the entrance, Mao Zedong was praised as China's great revolutionary. The late Deng Xiaoping was hailed as the reformer. And current President Jiang Zemin was dubbed the unifier. Inside, Rumsfeld found one exhibit to be particularly jarring. In a cavernous room devoted to Taiwan, a mural 30 feet long and 15 feet high depicted the Chinese military attacking the island with missiles, ships, submarines, and tanks. Chinese military officials told Rumsfeld and others in his group that while Beijing hopes to peacefully return Taiwan to the motherland, it must prepare its people for possible war.

To Rumsfeld, the exhibit helped drive home a conviction shared by several of the conservatives

THE MESSENGERS: now running Bush
Are Wolfowitz, Administration foreign
Rumsfeld, and the policy: that
rest of the team Washington has
pushing too hard? been far too com-

placent about China's intent to seize Taiwan by force, a conflict that surely would involve the U.S. As hard-liners see it, policymakers for too long have brushed aside mounting evidence, from war-mongering essays in Peoples Liberation Army (PLA) journals to cocky statements to U.S. visitors by Beijing officials, that China doubts America's resolve to risk its soldiers and commerce to fight for Taiwan. Clinton Administration talk of treating Beijing as a "partner" and repeated endorsement of a "one China" policy, they felt, boosted Beijing's confidence. "History shows that weakness is provocative," Rumsfeld said in his Senate confirmation hearing.

DIPLOMATIC DIGS. These deep suspicions of China are now translating into a sea change in U.S. policy. Gone is the decades-long stance of "strategic ambiguity" over whether the U.S. would intervene if China invaded Taiwan without provocation. At the same time, Washington is trying to lure other Asian powers to join its missile defense plan—a strategy that seems aimed at hemming in China and neutralizing its small



nuclear arsenal. In Tokyo, U.S. officials are talking with new Prime Minister Junichiro Koizumi about making Japan the center of America's security strategy for Asia. Then there are the diplomatic digs that have come almost daily since China's Apr. 12 release of the EP spy-plane crew. They include the Defense Dept. review of contacts with China's military, Bush's attack on Beijing religious repression, and the resumption of spy flights off China's coast.

As the Bush team views it, the harder line is carefully calibrated. Washington still favors a strong commercial relationship and collaboration with China on issues where the two nations' interests overlap, such as the Korean Penin-

The U.S.'s New Stance on China...

TAIWAN

President Bush said the U.S. would defend Taiwan if China attacked. On Apr. 24, the White House approved the biggest arms sale package to Taiwan in 12 years.

DOWNGRADED TIES

The Bush Administration has made it clear that it regards China as a strategic rival, rather than a partner, and that ties with Japan take precedence in Asia.

MISSILE DEFENSE

Top U.S. officials are visiting neighbors such as Japan, Russia, India, and Korea to seek cooperation on strategic missile defense, fostering Beijing's fear that it is being "contained."

MILITARY CONTACTS

The White House said any further contacts between the U.S. and Chinese militaries will be only on a case-by-case basis.

SPY PLAN

Just five weeks after the EP incident, the U.S. resumed reconnaissance flights off China's coast.

MISSILE: China may decide to build more





ula and the fight against narcotics trafficking. But the U.S. is no paper tiger where its geopolitical interests are at stake. "We do not view China as an enemy," James A. Kelly, Assistant Secretary of State for East Asia, told the Senate Foreign Relations Committee on May 1. "We view China as a partner on some issues and a competitor on others." Washington wants to make clear that China's missile arsenal, economic lout, and active diplomacy around Asia doesn't mean it holds all the cards.

Will this new policy backfire? So far, Beijing has responded mostly with propaganda blasts. But many of Bush's latest moves came during China's week-long May 1 holiday. Chinese leaders may

simply be reeling, and trying to discern where Bush is headed. Before long, predict China watchers, it will start striking back. Its options range from resuming arms sales to U.S. rivals such as Iraq to overwhelming any U.S. missile shield by ramping up its own nuclear program.

CLUMSY STYLE. The risk is that rather than clarifying U.S. intent, the Bush team is sowing dangerous confusion. Yan Xuetong, executive director of Beijing's Institute of International Studies, disputes the U.S. hawks' very premise for ditching "strategic ambiguity"—that China is fuzzy on the U.S. stand on Taiwan. "We know America will definitely be involved in a war [over Taiwan] without any hesitation," says Yan.

"This would be a war between China and the U.S." He predicts Washington will unwittingly provoke a Taiwan conflict within a decade, and says the PLA sees Bush's remarks as a cue to prepare for war.

Some veteran U.S. Sinologists who have been left out of Bush Administration policy circles are aghast at what they see as a clumsy, unilateral style. Washington, they say, is stoking many deep-seated fears among Beijing leaders: that they will lose Taiwan for good, that they are surrounded by U.S.-backed enemies, that foreigners are fomenting domestic unrest. "I'm afraid they are pushing too many buttons too quickly," says David L. Shambaugh, a China expert at George Washington University. "If you are sitting in Beijing, you are seeing an unrelentingly hostile U.S." One casualty, he says, could be nuclear non-proliferation: China has enough nuclear material to boost its arsenal of some 20 ICBMs tenfold within

SURVEILLANCE: two years.
The U.S. has Beijing views
resumed China Bush's missile defense
recon flights push as particularly
threatening. Top U.S.

officials such as Deputy Defense Secretary Paul D. Wolfowitz and Deputy Secretary of State Richard L. Armitage are visiting countries bordering China—including Japan, Russia, and India—to enlist their backing for a missile shield. Intended or not, that could make Beijing feel encircled—even though it will receive a visit from the lower-ranking Kelly. By taking too little heed of China's national interests and internal political pressures, warns Kenneth Lieberthal, a top National Security Council Asia policy adviser in the Clinton Administration, Bush's approach "creates the potential for disaster."

There's also the danger of severely undermining Jiang, Premier Zhu Rongji, and other Chinese leaders regarded as moderate. Despite Beijing's rhetoric, they have taken big risks to improve ties with the U.S.—but could end up having little to show for it. Military hard-liners could grow stronger in autumn 2002, when Beijing will select new leaders.

It's too early to tell whether Bush's foreign policy team, with its paucity of China experts, has thought through the ramifications of its policies. But for now, the attention shifts to Beijing. Will it respond with serious diplomacy or decide to prepare for a confrontation?

By Pete Engardio in New York, Stan Crock in Washington, and Mark L. Clifford in Hong Kong

...and How Beijing Could Respond

MORE NUKES

ounter a U.S. strategic missile shield, China could build more inter-continental ballistic missiles in two years to develop multiple warheads.

THREATEN TAIWAN

The Chinese could hurt the island's economy by threatening to blockade its ports or disrupt shipping in the Taiwan Strait, scaring away investors.

HELP ROGUES

It could resume weapons sales to Iraq, Iran, and other nations the U.S. is trying to isolate.

STRAFE BUSINESS

Beijing could retaliate against U.S. companies, building business pressure against Bush's policies.

UNDERMINED?
Reformers like Jiang could lose influence



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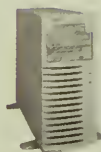
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COMMENTARY

By Stanley Reed

IT'S TIME FOR TONY BLAIR TO GET TOUGH



TOO WARY: If elected again, Blair should lead more forcefully

Few outside of the Conservative Party are predicting anything but victory for Prime Minister Tony Blair in the June 7 British general election. While a lot can happen in an intense, four-week campaign, Labour's lead, pegged at 18 percentage points by the MORI polling organization, looks close to insurmountable.

Yet there isn't any great enthusiasm for a second Blair term. Blair's strength in the polls owes more to the inadequacies of the Tories and their leader, William Hague, than to any great admiration for the 48-year-old Prime Minister. Blair is viewed as consumed with spin, while lacking in substance and ridiculously overcautious for a Prime Minister with a huge, 179-seat majority in the 659-seat Parliament. Blair's not being "radical" in the first term doesn't augur well for great deeds in the second, notes Frank Field, who served as Blair's minister for welfare reform but left in frustration in 1998. In fact, with the heretofore robust economy slowing and public cynicism on the rise, Blair could find himself paralyzed by fear of alienating this or that constituency and wind up accomplishing very little.

Blair's best hope of avoiding such a fate is simply to lead. If his party doesn't like it, tough. His great strength is that he is not a party hack. He is capable of thinking the unthinkable, and he may be headed

for another big majority. So he should capitalize on it and not worry so much about winning yet another election. Blair hopes to go down in history as a great modernizer who restored Britain's leadership of Europe and secured its place in the 21st century. To do that, the Prime Minister should give the public straight talk about what that will take.

NEW FOCUS. For starters, Blair should get real about what a modern leader can and can't do. To an American, Britain still seems vastly overcentralized. Blair winds up taking responsibility for everything from tackling the foot-and-mouth epidemic across the countryside to making the trains run on time. He should back off and focus on a few big issues.

One of those must be Britain's relations with Europe. Blair would be wise to end the dithering on whether or not Britain should adopt the euro. So far, he has let his aides and the

rabidly anti-Europe Murdoch-owned press set the agenda. Blair has promised a review on the euro two years into the next term. He should use the occasion to make Britain's intentions clearer. Yet at the moment, Blair is leaving this crucial matter largely to Chancellor of the Exchequer Gordon Brown. Blair should take back the portfolio.

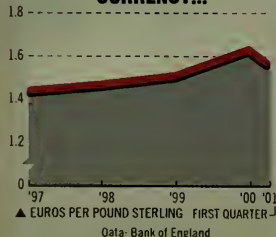
It is not an easy choice. Voting "yes" to join the euro zone would subordinate British monetary policy to the much-scorned European Central Bank in

Frankfurt and draw Britain further into the embrace of the Continental economies. But it would give Britain more negotiating power, including on its terms of entry. A "no" will likely mean permanent second-class status for Britain in European councils. And it may mean further decimation of British manufacturing as companies' margins are eroded by the strong pound. Blair has to decide which course makes sense for preserving Britain's status as the top destination for foreign investment in Europe.

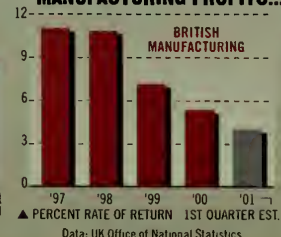
Another key issue is the one voters complain about the most—public services. Many who back Blair are disappointed that education, a big Labour issue, hasn't improved much and that the National Health Service, also a sacred cow, is going backward. Blair should make clear that these are societal headaches that government can't easily cure. And he should offer realistic solutions. For the NHS, that means busting the bureaucracy and giving authority to local hospitals to set priorities.

Such proposals, if implemented, might reduce Blair's own opportunities to claim credit. But they just might lead to the "fresh and radical change" for which Blair says he needs a second term.

BRITAIN'S STRONG CURRENCY...



...IS HURTING MANUFACTURING PROFITS...



...AND HELPING TO SLOW THE ECONOMY



Reed is London bureau chief.

TODAY

**Develop smart highway
systems to help traffic
move more smoothly**



TOMORROW

Think up new excuses for
being late to work

TOYOTA

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"My long-lost uncle dropped in for tea."

"A squirrel short-circuited the garage door."

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GROUND

Clad in a blue lab coat, a technician in Singapore waves a scanner like a wand over a box of newly minted computer chips. With that simple act, he sets in motion a delivery process that is efficient and automated, almost to the point of magic. This cavernous National Semiconductor Corp. warehouse was designed and built by shipping wizards at United Parcel Service Inc. It is UPS's computers that speed the box of chips to a loading dock, then to truck, to plane, and to truck once again. In just 12 hours, the chips will reach one of National's customers, a PC maker half a world away in Silicon Valley. Throughout the journey, electronic tags embedded in the chips will let the customer track the order with accuracy down to about three feet.

While the logistics are extraordinary, they tell only half the story. A similar warehouse in Singapore was constructed seven years ago by UPS rival Federal Express. But FedEx Corp., as it's now called, never managed to make the operation pay off. "They dropped the ball," says Kelvin Phillips, National's director of worldwide logistics. The FedEx team was inflexible, he explains. They forced the chipmaker to ship everything the most expensive way, via overnight air express—even if a shipment didn't require that kind of speed. And under FedEx, the Singapore warehouse never delivered on its promise of streamlining chip inventory. Finally, in 1999, Phillips yanked the business from FedEx and handed it to UPS, which rebuilt the operation from scratch. In the two years since, the team in brown has slashed National Semiconductor's inventory and shipment costs by 15%.

The Singapore story is no isolated triumph for UPS. Over the past two years, the company has quietly shed its image as the slowpoke of shipping. Be it e-tailing frenzy or dot-com crash, UPS has captured customers by bombarding them with choices: fast flights vs. cheap ground delivery, simple shipping or a panoply of manufacturing, warehousing, and supply-chain services. In the U.S. and several foreign markets, UPS has grabbed a commanding lead over FedEx—and not just in everyday package delivery but in the New Economy services such as logistics. In North America, UPS has even

snagged the distinction of preferred carrier to the Web generation: The company handles 55% of all online purchases, vs. 10% for FedEx. "UPS is doing things in e-commerce that other companies are just starting to talk about," says Jack R. Staff, chief economist at Zona Research in Redwood City, Calif.

The ascent of UPS charts a reversal of fortune in one of the fiercest rivalries in Corporate America. It was FedEx, after all, that pioneered both overnight delivery of packages and the ability to track their journey using computers. These 1970s' era innovations rocked the shipping industry and helped set the stage for the Internet Revolution of the 1990s. Even now, FedEx rules in certain areas of air freight. It carefully burnished brand still says "absolutely, positively" to thousands of loyal customers—and not without reason. FedEx



WARS

UPS's rapid ascent leaves FedEx scrambling



eked out just \$688 million in profits. As the economy slows and competition gets more brutal, both companies are feeling the pain. FedEx's profits were down 4% in its latest quarter, and UPS's were down 8.9% in the quarter ended Mar. 31. FedEx has warned that things will get worse.

FedEx Chairman Frederick W. Smith and other top executives declined to discuss these results with *BusinessWeek*. But William G. Margaritis, FedEx's corporate vice-president for worldwide communications and investor relations, insists that the company's performance is up to snuff. "FedEx has a proven track record of delivering solid financial results," he said in a written response to questions from *BusinessWeek*. "Our compound annual earnings-per-share growth rate over the past 10 years is 15.6%."

In the view of many analysts and industry execs, however, UPS now has a pronounced advantage in several hotly contested areas. In addition to its overwhelming lead in ground shipping and its online triumphs, UPS can point to a logistics business that is growing by 40% a year. FedEx is struggling to reverse a decline in this area.

Even in sectors where FedEx still rules, UPS is catching up quickly. FedEx has a commanding lead in the profitable overnight service, for example, delivering more than 3 million such packages daily in 200-plus countries and accounting for 39% of the market. UPS is No. 2, with 2.2 million overnight packages—but its volume has been growing faster than FedEx's for at least

Industries

UPS vs. FEDEX

three years. In 2000, UPS's overnight business grew at 8%, compared with FedEx's 3.6%. And UPS's operating margin on its domestic air-express service is higher—24% vs. 6%—according to Gary H. Yablon, a transportation analyst at Credit Suisse First Boston.

In his written response to *BusinessWeek*, Margaritis denied that the company is losing significant ground. "UPS has never caught up and passed FedEx in any arena," he wrote, "certainly not when it comes to reliability, technology initiative, global reach, or brand strength."

So what accounts for UPS's growth in overnight? The company trumpets its decision in 1999 to integrate overnight delivery into its vast ground-transportation network. UPS, like FedEx, still uses planes to make most such deliveries. But in the past two years, its logisticians have also figured out how to make quick mid-distance deliveries—as far as 500 miles in one night—by truck, which is much less expensive than by air. As a result, UPS's overall cost per package is \$6.65, compared with FedEx's \$11.89, according to CSFB. Even though

is one of America's great success stories, extolled for its customer service. David Lord, the founder of now defunct dot-com e-tailer Toysmart.com, hails the enthusiasm FedEx brought to his business in its early stages. "The shipper went so far as to keep trucks idling outside his small company, ready to move orders as soon as they came in. I was nobody, but FedEx treated me like a king," he recalls. Nevertheless, on many fronts, UPS is winning the battles. And the companies' diverging fortunes are starting to show up on the bottom line. In revenues, both giants enjoy comparable growth: UPS surged 11% in 2000, to \$30 billion, while FedEx's revenues grew 8.8%, to \$18 billion. But in the same period, UPS eked in \$2.8 billion in profits, giving it an operating margin of 5.3%. That's roughly double the margin at FedEx, which



ups		FedEx
1907	FOUNDED	1971
James P. Kelly	CHAIRMAN	Frederick W. Smith*
Atlanta, Ga.	HEADQUARTERS	Memphis, Tenn.
\$29.77 billion	2000 REVENUE	\$18.3 billion
\$2.93 billion	NET INCOME	\$688 million
359,000	EMPLOYEES	215,000
13.2 million	DAILY PACKAGE VOLUME	5 million
152,500 trucks, 560 planes	FLEET	43,500 trucks, 662 planes
Data: Companies		* and founder



FedEx also uses trucks for short hauls, "UPS has a real cost advantage," says John D. Kasarda, director of the University of North Carolina's Frank Hawkins Kenan Institute of Private Enterprise and a former FedEx consultant.

UPS's core strength is its fleet of 152,000 brown trucks, which reach virtually every address in the U.S.—and increasingly, the world. FedEx has belatedly begun to build its own home-delivery system. But the cost of duplicating a system UPS has spent nearly 100 years building could prove prohibitive. And with \$3 billion in cash on hand, UPS could easily wage a price war against FedEx, which isn't generating any spare cash. "This is a game FedEx can't win," says Peter V. Coleman, a transportation analyst at Banc of America Securities. That leaves FedEx dependent on an air-delivery system that is increasingly expensive to operate.

COPYCAT. To appreciate how deftly UPS has turned things around, one must consider how badly the company was tripped up by its rival's meteoric success. UPS had experimented with air delivery for decades. But it was 27-year-old Frederick W. Smith, a Yale University graduate and Vietnam War veteran, who got the idea off the ground in 1971. Within five years, Federal Express was soaring—and the package-delivery business would never be the same.

UPS didn't counter with its own overnight service until 1988. The explanation for this may lie in its corporate culture. UPS was founded as a messenger service 94 years ago by James E. Casey, who ran the company like a military operation, ordering recruits to be polite at all times and to place speed above all other virtues. To this day, workers at UPS headquarters are forbidden to drink coffee at their desks.

This rigid culture didn't breed risk-taking. But by the mid-1980s, FedEx's success had earned a deep respect from its competitor. Not only did UPS begin to ape FedEx's tactics, it was able to duplicate the results—and often at a lower cost. UPS drivers started following their rivals' trucks to learn their methods and to poach customers. "It was warfare," says ex-FedEx exec Christos Cotsakos, now chairman of online broker E*Trade Group Inc. "We were soldiers at FedEx on a holy crusade."

Poling its customers, UPS learned that they desired FedEx-style express and tracking services—and that required better information technology. It took UPS 15 years to build a computer system that rivaled FedEx's renowned Cosmos system. But UPS chose a wiser approach. While FedEx forced customers to adopt its proprietary software, UPS designed logistics software that worked with any corporate system. And when FedEx shunned alliances until recently, UPS jumped into partnerships with giants such as Oracle Corp. and IBM. Its cheaper shipping rates also won UPS the allegiance of dot-com leaders—while they lasted. And when the bubble popped, UPS came to rest on solid brick-and-mortar—namely, Wal-Mart Stores, Ford Motor, and others in that class.

Carefully mimicking FedEx, UPS gradually mastered the intricacies of logistics. But retrofitting a computer-centric culture to this erstwhile trucking company proved a Herculean effort. Well into the 1990s, a 1950s-style engineering culture ruled at UPS, complete with myriad rules addressing everything from women's dress to cafeteria protocol. On the road, drivers followed near-military regimens after being drilled on such details as how to quickly buckle and unbuckle seat belts. So when faced with Internet-era business challenges, top executives felt the company needed a fresh start. In 1994, they set up a new logistics group in a building a few miles north of the main campus in suburban Atlanta. Soon, many employees were clamoring to switch over to the new unit. "Everyone knows now that logistics is the place where you can go ahead," confides one junior UPS executive.

The new unit quickly paid its way. UPS's logistics revenues—excluding conventional shipping activities—grew 58% last year, topping \$1 billion, and is poised for an additional 40% spurt. "I expect UPS to double its logistics business within the next four to five years," says Edward M. Wolfe, transportation analyst at Bear Stearns & Co. In contrast, he says: "FedEx has lost momentum."

FedEx won't break out its results in logistics. But the company tacitly acknowledged a setback when it announced a thorough overhaul of the business late last year. From nov



n, it will focus solely on providing technology solutions to customers—showing them new ways to track packages, for example. FedEx's Margaritis derides UPS's hands-on approach as old-fashioned "pick-and-pack warehousing." And he says FedEx is reevaluating all of its logistics accounts, looking to weed out ones that don't fit the new strategy.

FedEx will have to move fast to avoid more defections from customers such as National Semiconductor. E-tailer SmartHome.com dumped FedEx for UPS because the former "just didn't have the software and systems for us to revolutionize our operations," says Purchasing Director Michael Limon. UPS redesigned SmartHome.com's business from warehouse to Web site, plugging its package-tracking software into SmartHome.com's site so customers could use the feature without leaving the site. But it studiously left options open—visitors can even select shippers other than UPS. SmartHome staffers used to field about 60 calls a day from customers with shipping queries. Now, those staffers can spend their time making sales pitches.

Meanwhile, in the Old Economy, UPS is winning giant customers such as Ford Motor Co., which uses UPS's computer-

ized logistics to route cars more efficiently to its dealerships. In a year, Ford has reduced delivery times by 26% and saved \$240 million, says Frank M. Taylor, Ford's vice-president for material planning and logistics. "Speed is the mindset at UPS. They'll meet a deadline at any cost," Taylor says. UPS Chairman James P. Kelly chalks it up to the company's slow-and-steady work ethic. "We've spent the past seven years studying where we should be long-term," he says.

While FedEx backpedals in logistics, UPS is in growth mode. And it has figured out how to manage distribution for many companies at one central location—a massive warehouse in Louisville, Ky. Here, UPS handles storage, tracking, repair, and shipping for clients such as Sprint, Hewlett-Packard, and Nike using a mix of high- and low-tech methods. Computerized forklifts scan in new inventory while people in sneakers dash across the vast warehouse to pluck products, box them, and ship them out. In short, UPS uses expensive technology only where it cuts costs.

HUBRIS. The story of

UPS's remarkable comeback is mirrored—almost blow for blow—by miscalculations and botched opportunities on the part of FedEx. And while FedEx has instituted some promising initiatives in recent months, many analysts believe that it may be too late for FedEx to make up for lost ground.

The seeds of FedEx's current woes were sown in the late 1980s. That's when Smith and other top execs—blinded by annual earnings growth averaging 40%—fell into hubris. According to one former executive who asked to remain anonymous, Smith ignored opportunities to build up a residential ground-delivery network, instead putting all of the company's eggs in higher-cost air transport. Says the UNC's Kasarda: "UPS moved quicker into FedEx's turf than FedEx moved into that of UPS." And while Smith's early romance with computers gave him critical traction on the Internet, the technology is now undermining the choicest part of FedEx's operations: overnight delivery, which makes up 50% of its revenues. FedEx's own numbers show that about one-quarter of this business, or 749,000 parcels, are letter-size envelopes. Expand this category to include legal briefs, manuscripts, contracts, and other documents, and the category makes up fully 40% of FedEx's overnight traffic. Virtually all of this material can be transmitted electronically or posted online and downloaded when the need arises.

For now, digital delivery is in its infancy, and the impact on FedEx is less than catastrophic. Overnight shipments of letter-sized parcels fell just 2% year-to-year in the quarter ended Feb. 28. But Brian Clancy, a principal at Arlington (Va.) transportation consultant MergeGlobal Inc., expects more

Industries

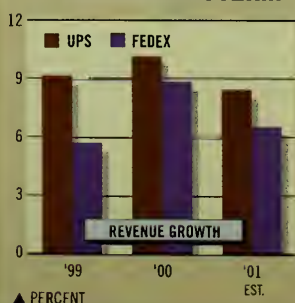
UPS vs. FEDEX

SUCCESS BEGETS SUCCESS

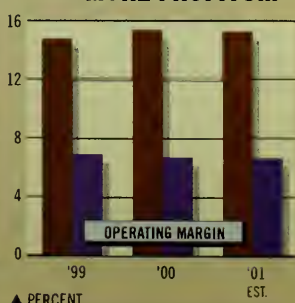
Stacking UPS up against FedEx

Data: Banc of America Securities

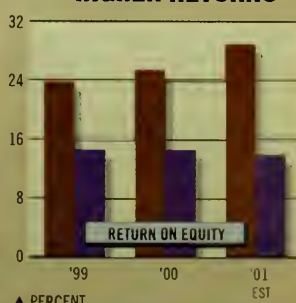
UPS IS GROWING FASTER...



...AND SQUEEZING OUT MORE PROFITS...



...SO IT EARNS HIGHER RETURNS





KELLY: He credits UPS's slow-and-steady work ethic

WHAT'S UP IN THE AIR... AND ON THE GROUND

FedEx rules the skies, but UPS is bigger on land. Overall, UPS earns more on each package.

	UNIT COST	UNIT PROFIT	OPERATING MARGIN	AVG DAILY VOLUME
AIR DELIVERIES, U.S.				
FEDEX	\$15.27	\$0.93	6%	2,924,000
UPS	\$14.60	\$3.76	22%	2,162,000
GROUND DELIVERIES, U.S.				
FEDEX	\$4.77	\$0.68	13%	1,541,000
UPS	\$4.95	\$0.61	11%	10,945,000
OVERALL AVERAGE, INCLUDING INTERNATIONAL				
FEDEX	\$11.89	\$0.85	7%	4,788,000
UPS	\$6.65	\$1.17	15%	14,236,000

Data: Credit Suisse First Boston



SMITH: No one is counting the wily FedEx founder out

precipitous declines. Online security is improving quickly, he notes. And businesses are starting to adopt contractual devices such as digital signatures. As these technologies mature, the electronic transit of everything from real-estate closings to legal settlements is poised to explode—at the expense of shipping. “FedEx is definitely exposed,” says Clancy.

So is UPS. But since the company still derives most of its business from ground delivery, it is far less dependent on overnight service. And it doesn't share FedEx's worries about the bottom line. Despite operating in the greatest economic boom in its history, FedEx remains narrowly profitable. “The company is woefully underperforming,” says BofA analyst Coleman.

Margaritis repudiates this critique. He says FedEx anticipated the threat from the Net years ago. “That's why we've expanded into new lines such as home delivery and logistics,” he says.

In the meantime, FedEx intends to strengthen its own already-formidable position in foreign markets. Right now, only 10% of all deliveries outside the U.S. are overnight. Consultants believe the leader now is Brussels-based DHL International Ltd., controlled by Deutsche Post, which has an estimated 20% to 25% of the international overnight market. But FedEx is tied for second place with TNT Post Group, each with about 10% to 15% of the market. UPS is third, with an 8%-to-12% share. FedEx's intercontinental parcel service grew 11% in the nine months ended Feb. 28. That's faster than any of FedEx's other operations. To juice it even further, FedEx has become the first shipper to gamble on Airbus Industrie's A380-800F air freighter. The triple-decker, which hasn't been built yet, will travel nonstop to just about anywhere in the world within 48 hours while carrying nearly twice the payload of the largest existing jet freighter.

FedEx is even making some progress in the ground war with UPS. It recently struck a \$7 billion distribution deal with the U.S. Postal Service, hoping to squeeze more revenue out of every plane. The Postal Service will help fill planes that are now flying partially empty. As for FedEx's own trucks, they have served largely as the last leg in overnight delivery. But four years ago, FedEx spent \$500 million to buy a ground network to serve businesses. This year, it will shell out an addi-

tional \$150 million to expand the system in hopes of reaching a U.S. homes by 2002. The strategy, explains Margaritis, is not to compete “head-to-head” with UPS but rather to skim off the best customers with a new portfolio of premium services. FedEx charges extra for those services, which include night and Saturday deliveries—neither of which is now offered by UPS.

FedEx recognizes that its dependence on a jet fleet saddles it with the highest cost structure among all shippers. Indeed, the company has largely been cash-flow negative over its 30-year history, due to heavy investments in expansion. The latest drain is FedEx's ground-delivery system. Wal Street, however, is now demanding that the company show positive cash flow. FedEx promises to comply by the end of the year, by cutting costs and squeezing more revenue out of current operations. “Our mantra now is not just to grow, but grow profitably,” says Margaritis. At least some of the company's fans are encouraged. “FedEx is on the right path,” says Roger Mendel, a vice-president at Northern Trust Corp. which owns 1.1 million FedEx shares.

But even Mendel says the company has a lot of work to do. Overseas, rival UPS has scored a major coup: It won six new direct air routes to China from the U.S. in January. Transportation Dept. in January, breaking FedEx's six-year stranglehold on such traffic. As for FedEx's U.S. strategy, analysts say buyers still aren't biting at its premium services.

BofA's Coleman sees little evidence that FedEx's new efforts on the ground will pay off. Because it insists on running its four main services as independent businesses, the company misses out on the cost-saving synergies that UPS has mastered. And while FedEx's nascent residential ground-delivery service has captured 11% of the market, it can't keep up with UPS, which spends \$70 million-plus a year to expand its ground facilities. Analysts estimate that FedEx is already losing \$18 million a quarter on residential ground delivery.

No one is counting the wily Smith out of the game altogether. But in the long run, his fleet of red-and-blue planes may prove no match for the countless ranks of UPS's slow-moving brown trucks of its bulging war chest. Like the tortoise in the old fable, UPS is progressing slowly but surely. And in this particular chapter of the story, the hare's stumbles are only helping the tortoise reach his goal.

By Charles Haddad in Atlanta with Jack Ewing in Frankfurt

Industries

UPS vs. FEDEX

UPS KEEPS THE BEAR AT BAY

Earnings disappointments have rattled FedEx's stock price over the past half-year. The team in brown has done a better job of shoring up its share price.

	UPS	FEDEX
SIX-MONTH RETURN	-1.9%	-17.5%
YEAR RETURN	-8.0	-4.3
CURRENT P-E RATIO	25.18	16.85

Data: Bloomberg Financial Markets

HELP.



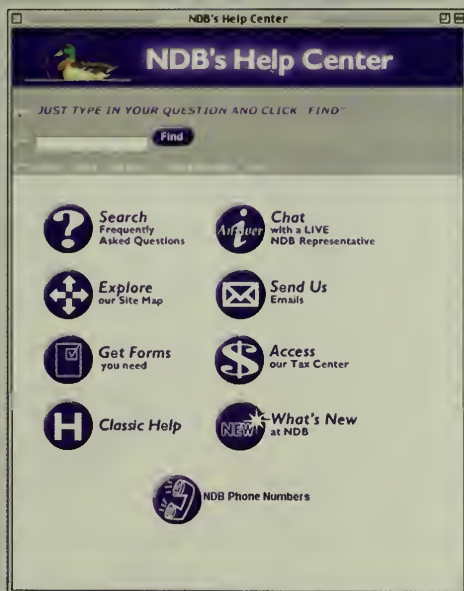
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CONTINUED FROM PAGE 11

Pursuant to the aforementioned stipulations specified in article IV. Signed through f, the undersigned, Mr. Henry Peterson, acknowledges that he has read and understands the foregoing provisions and employment requirements. This authorization will remain irrevocable and for as long as the aforementioned under signed remains a citizen of the United States. Further, the undersigned Henry J. Peterson _____ will hereby be known and referred to as Henry J. Peterson, _____ under the aliases "Henry Joe," "Henry," "Hank," "Joe-boy," and "Slappy," until further notice or unless _____ the documents contained herein. Signed _____ Henry J. Peterson, _____ I, the undersigned, _____ refute and officially retract the above statements and deem them to be untrue and more "hogwash" and thereby nullify and void the agreement specified therein until further notice and/or until I am advised by my qualified legal counsel. Signed _____ Henry J. Peterson, _____ I, the undersigned, _____ under the aliases listed above and below _____ exercise my rights, duties, or responsibilities as specified in the articles of incorporation, or cannot exercise my rights, duties, or responsibilities, hereby _____ simultaneously assign non-durable powers to my fictitious and _____ spouse, hereby known as Mrs. _____ K. Peterson. Signed _____ Henry J. Peterson _____ Mrs. Cindy K. Peterson. For and valuable consideration, the undersigned hereby _____ states the rates at which he will be compensated for his services starting _____ of gross margin, with increments _____ implemented every 30 seconds from the time of signing. Fees _____ will be levied in an unfair and unreasonable manner entirely at the discretion of the undersigned, with no provision _____ on the part of the vendor at any time, including the 60 day "limbo" period as specified in no other document _____ drawn. Signed _____ Henry J. Peterson. The above provisions include _____ are not limited to the aforementioned parties, Henry J. Peterson, his wife, his child, any affiliated companies and business associates, _____ officers, agents, the Easter Bunny, Santa Claus, and _____ I went to college with but can't find the life of me remember his name. Signed _____ the least of my ability, I _____ to making a batch of fresh cookies and delivering them _____, to my _____ Henry J. Peterson _____ shall be noted here that authentic in form and language _____ contents contained herein and articles shown have no legal merit whatsoever and are in no way legally binding for _____ signed parties listed herein.

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Developments to Watch

BY OTIS PORT

From May 6 to 11, Baltimore's harbor area swarmed with some 8,000 visitors and speakers peering into the future at the annual Conference on Lasers & Electro-Optics, better known as CLEO. Senior Writer Port filed the following reports:



STROBES THAT CAN CATCH AN ELECTRON IN ACTION?

MANY KEY PROCESSES IN chemistry, physics, and biology—notably protein folding—take place in such fleeting instants that scientists can only guess at what's happening. To freeze the action, they need an ultrafast strobe light. Ahmed H. Zewail of California Institute of Technology won a 1999 Nobel prize for developing an X-ray strobe that emitted pulses lasting just a few hundred femtoseconds, or quadrillionths of a second. (It's harder to grasp how ephemeral this is, but if one femtosecond were stretched to a full second, that second would last 30 million years.)

Protein folding is faster still. So the quest for speedier strobes continues. Last year, a team from Austria, Germany, and Canada set a new record

for brevity: an X-ray pulse lasting a mere 1.8 femtoseconds. The flash (the purple stream in the photo) was produced by shooting an infrared laser into a jet of ionized helium erupting from a tiny metal tube at Vienna Institute of Technology's Photonics Institute.

Even faster strobes could be coming. The researchers are confident that they will soon move down into the attosecond realm. An attosecond is 1,000th of a femtosecond. Such flashes might enable scientists to observe electrons in atoms.

STOPPING LIGHT DEAD IN ITS TRACKS

EARLY THIS YEAR, TWO TEAMS—one led by Harvard University physicist Lene V. Hau, the other by Ronald L. Walsworth at the Harvard-Smithsonian Center for Astrophysics—independently wowed the scientific world by stopping light dead in its tracks. The feat lasted only milliseconds, and only in clouds of gas. Still, it touched off speculation about potential applications, such as optical memories for storing data in future supercomputers.

Now, a third team has shown that optical-bit storage is inching closer to prac-

ticality—in the form of a crystal that promises to stop light. Using an yttrium-silica crystal seeded with praseodymium, an exotic metal, the team slowed light to the relative snail's pace of 45 meters per second.

Team leaders Philip R. Hemmer, a physicist at the Air Force Research Laboratory in Bedford, Mass., and Massachusetts Institute of Technology researcher Selim M. Shahriar, hope to go further. By fine-tuning the crystal's recipe, Shahriar says he expects to corral light "for as long as a second in the fairly near future." A crystal with that power could work in an all-optical telecom switch, or for transient data storage in optical or quantum computers.

FANTASTIC NANO-VOYAGE

CERTAIN WAVELENGTHS OF infrared light can penetrate about one inch of human tissue. That's enough to open the door to some exciting vistas in medical imaging: pictures sharper than ultrasound and without the radiation of X-rays. Naomi J. Halas, an electrical engineer at Rice University, heads a team that is developing tiny, infrared-sensitive particles, which she calls nanoshells, to use as implantable drug pumps and instant tests for allergies or viruses.

Like seashells, nanoshells are composite structures. Glass spheres, 40 to 60 nanometers in diameter, are covered with 3 to 20 nm of

gold. The image (right) shows the progressive growth of the gold layer. By varying the core size and metal thickness, researchers can tune the particles to respond to specific frequencies. In one application, chemicals sensitive to allergens are attached to the gold. After the particles are ingested, any reactions can be spotted by drawing a small blood sample and testing it with various reagents.

Halas figures doctors would



do most testing in their offices, ending the wait for results when tests are sent to a lab.

Another idea is to embed the shells in a plastic, along with a drug. The spheres absorb infrared energy, heat up, and

GLASS SPHERES COVERED WITH GOLD ARE INFRARED-SENSITIVE

trigger the plastic to release the drug. Similarly, researchers at Osaka University in Japan use infrared energy to recharge a battery for a pacemaker or insulin pump.

INNOVATIONS

■ By decade's end, light will no longer be able to print chips with thinner lines. That's because all conventional lenses have a positive index of refraction, meaning they bend light in only one direction. This limits their sharpness. Last year, John B.

Pendry, a physicist at London's Imperial College, speculated that a negative-index lens was possible and that it could create lines far thinner than those imagined by chipmakers. Now, researchers at the University of California at San Diego have built such a lens for microwaves—but not light. Pendry remains up-

beat about the prospect of a negative-index lens for light.

■ Computing with rainbows? University of Rochester researchers did it at CLEO. But only an optics engineer is likely to understand how. Here's the idea: A single pulse of light with many colors, each representing bits of data, is split in two. One half

passes through a special filter. When the pulses are recombined, then split again, a spectrometer can read the results—in this case, the location of a desired citation in a 50-document database. This is no big deal, but the team thinks the principle could speed searches through astronomically huge databases.

GOING PUBLIC

KPMG'S BRAVE LEAP INTO THE COLD

The first Big Five consulting firm to sell shares is wrestling with wrenching change

CEO BLAZER SAYS FINANCIALS ARE CHECKED CONSTANTLY NOW INSTEAD OF JUST ONCE A YEAR

Eighteen months ago, KPMG Consulting was securely tethered to the accounting arm of KPMG LLP and mired in the inbred atmosphere of a Big Five consulting firm. Hundreds of partners ran their parts of the business as separate fiefdoms, all under the sheltering canopy of KPMG. No more. The consultants split from the accountants in January, 2000, and went public a year later, becoming the first of the Big Five firms—but not the last—to transform itself from a private partnership into a public company.

These days, investors, clients, and competitors are watching closely as KPMG Consulting, based in McLean, Va., struggles with wrenching cultural changes. Transformations large and small are visible everywhere in the \$2.4 billion company. The massive mahogany desks and expansive offices once occupied by KPMG's venerated partners have given way to cookie-cutter work spaces, pint-size offices, and managing directors. Gone are the days when a client could wait indefinitely to pay. And directors who don't make their cash-flow numbers can expect a call from CEO Randolph C. Blazer. "As a partnership, if you don't get to the numbers, you

don't get to the numbers," says Blazer. "In a public context, part of our reward is appreciation of the stock price, and you're not going to get that unless you're hitting the numbers you said you were going to hit."

Hitting those performance targets is about to get a lot harder. KPMG Consulting's bread-and-butter business, the

integration of big-company computer systems, is showing distinct signs of a slowdown. Results in its first post-partnership quarter—\$42.2 million in operating profits on \$751 million in revenue in the three months ended Mar. 30—were respectable, but clients canceled or delayed \$180 million worth of contracts in the quarter, and analysts predict that business will be sluggish over the next six months. Already, shares are trading at about \$17, 30% off their high. "I've never seen a tougher environment," says F. Mark D'Annunzio, the chief of the computer-services consulting group at Deutsche Bank Alex. Brown.

That's not what KPMG's senior partners had in mind two years ago when they first kicked around the idea of an initial public offering. The Securities & Exchange Commission was pressuring the Big Five firms to set their consultants free, arguing that having auditors and consultants under the same corporate roof posed an irreconcilable conflict of interest. Besides, back then, business was booming and expectations for KPMG's consulting arm, with its 36% compound annual growth rate, were particularly high. Partners saw a

PLANNING AN IPO? LOOK BEFORE YOU LEAP

Some lessons KPMG Consulting has learned:

Diversify KPMG's public-service group is expected to help offset near-term softness in some of its other practices—especially the technology group.

Be Picky Choose your allies carefully: Marketing partners Cisco Systems and Oracle are sound, but KPMG's \$63.3 million investment in Qwest Cyber Solutions was a total loss.

Don't Wait Ax personnel quickly. Two recent rounds of layoffs signaled to Wall Street that KPMG values the opinion of the public markets.

Time It Right Because KPMG went public in a sour economy, its shares are hovering below the \$18 IPO price, employee stock options are under water, and near-term growth will be slow.

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The Corporation

chance to use newly minted stock to acquire KPMG operations in Europe and issue options to lure talent.

KPMG execs got their first taste of the rigors of life as a public company when they met with the sales force of lead underwriter Morgan Stanley Dean Witter & Co. in January, and again two days later, at a meeting with potential investors in Frankfurt. No one, they found, cared a whit about the "story" of KPMG Consulting and its fabled 131-year history as a white-shoe firm. All they cared about were the financials. It was an eye-opener. Says Chief Financial Officer Bob Lamb: "This firm never talked about compensation and tax rates. We're doing that now."

UNDER SCRUTINY. That emphasis on financial performance has led to some painful choices. KPMG Consulting has already laid off 800 of its 10,000 employees in the past 16 months, for which it will take a \$15 million to \$20 million charge. Dan Johnson, an executive vice-president who keeps a Wall Street sign in his office in the company's headquarters, recently fired another 25 consultants working on government projects. Why? The work wasn't profitable enough. "You have to move quicker," Johnson says.

NO ROOM A former partner says KPMG Consulting will have to rid itself of dozens of highly paid, underperforming partners. CEO Blazer says many have already left

"You can't wait." Even harsher measures could be on the way. A former partner says KPMG Consulting will have to rid itself of the last remnants of the old regime: dozens of highly paid, underperforming partners. Blazer says many have already departed, both voluntarily and involuntarily, and that the issue will continue to be addressed.

Those who are left have had to adapt to an environment in which the focus is firmly on the numbers. Instead of measuring profitability once a year—standard operating procedure in the partnership—the company now monitors financials constantly. Every Friday, Senior Vice-President Kenneth C. Taormina grills his sales force on every would-be client: "I go through every single deal [asking] 'What do we need to get it done?'" Even the office kitty that partners dipped into freely for morale-build-

ing activities such as staff dinners is now under scrutiny. "There's a lot more emphasis on measuring things that we wouldn't have measured before," says Managing Director Darryl B. Moody.

And these days, most former partners, who once had full access to KPMG's financial data, now find out how the company is doing at the same time as outside investors. Many of the 630 managing directors asked Blazer to declare them corporate insiders—with restrictions on trading stock—in order to retain their old access to the financials. Blazer refused, saying there were just too many.

Rivals are watching KPMG Consult-

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ing's metamorphosis for what may be a store for them. And with good reason: Two similar experiments in public ownership—Arthur D. Little Inc. in the 1960s and Booz, Allen & Hamilton Inc. in the 1970s—ended with both firms eventually reverting to private owner-

ship. Today, four Big Five firms have sold consulting units or announced plans to do so. Accenture (formerly Andersen Consulting) plans a \$1 billion IPO. PricewaterhouseCoopers, which tried to sell its consulting arm to Hewlett-Packard Co. last fall, may follow.

Will KPMG manage to thrive as a public concern? Even with the dismal business outlook over the short term, the company has considerable strengths. With 2,500 clients and an enviable retention rate, it has been shielded from the wild revenue fluctuations that turn off investors, despite deriving half its revenues from e-commerce. A solid public-services practice, which brings in a third of its revenue, and joint-marketing agreements with Cisco Systems, Oracle, and Microsoft also go a long way toward providing predictable growth. And clients say they like the new KPMG Consulting. Says Ed Mulvey, vice-president for strategy and e-business at Honeywell International Inc.'s aerospace-services unit: "You definitely sense the enthusiasm of people having a piece of the business."

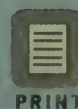
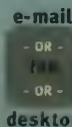
As the first of the Big Five consulting partnerships to go public, KPMG Consulting is clearly the canary in the coal mine. But Blazer is confident that despite a soft business outlook and the changes wrought by public ownership, his firm will thrive. If it does, look for other big consultants to start flocking to the public markets, too.

By Louis Lavelle in McLean, Va.

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A BUDGET CHIEF CALLED 'THE BLADE'

Mitch Daniels has a sharp knife—and sharp elbows

When George W. Bush spies Mitch Daniels, he usually greets his budget director with a grin and a nickname: "The Blade." Daniels, a slight, reticent man who looks more like a clerk than a slasher, is doing his best to live up to his handle.

The former Reagan operative, who was plucked from his post as senior vice-president at Eli Lilly & Co., has rushed into his new job at the Office of Management & Budget with scalpel in hand. Daniels fought hard for an accord that commits Republicans to holding the growth of discretionary spending to about 5%, vs. last year's 8%, brushing aside Senate moderates' calls for more social spending. And when Democrats complained that he was singling out Clinton initiatives for cuts, among them a popular program that puts more cops on the beat, Daniels declined to feel their pain. At OMB, his aides have adopted as their theme song the Rolling Stones hit *You Can't Always Get What You Want*.

Daniels' elbows are just as sharp as his budget knife. When Senate Minority Leader Thomas A. Daschle (D-S.D.) claimed the decision by Congress to fund only \$1.25 trillion of the President's \$1.6 trillion tax cut was a triumph for his side, Daniels told CNN: "There are some jobs—and I guess Senator Daschle's is one—that require you to say silly things from time to time."

Ouch! Washington should expect more

such machete strokes from Mitch the Knife. A onetime political director in the Reagan White House, Daniels was happily toiling for Lilly and had no plans to join Team Bush. But Dubya's first choice for budget director, Stanford economist John F. Cogan, passed up the job, and the Bushies had to scramble.

Vice-President Dick Cheney, along

him anathema to conservatives. So it was hardly a surprise when Dubya made clear that he wanted a sort of anti-Darman as budget chief.

Enter Daniels. Although he lacked apparent credentials as a numbers-cruncher, the Indianapolis native got the nod over such OMB wannabes as former House Budget Committee Chairman John R. Kasich. Daniels was so green that when it came time to shape the fiscal 2002 budget, Cogan was airlifted in to assist. "Mitch was no budget guru. He was just a smart guy we had confidence in," says White House Chief of Staff Andrew H. Card Jr. "It was an important pick. The President knows as an ex-governor that the budget drives policy."

Daniels forswears any grand ambitions to formulate policy. Instead, he wants to quietly slog through Bush's checklist of budgetary challenges. Among them, preparing for the Baby Boomer retire-

ment wave by boosting Social Security returns, coping with the Medicare cost explosion, and doing some behavioral modification on a Congress grown accustomed to gluttony at the federal trough. In addition, Daniels vows to help Bush fulfill his promise to curb regulation of business by applying stringent cost-benefit analysis to proposed rules. "These are very ambitious goals," Daniels says. "One of the reasons I went to work for President Bush is that he was prepared to go after the big game."

RED INK. Fortunately for the Blade, he comes to this task with something his predecessors didn't have—money. While most recent budget chiefs had to agonize over buckets of red

ink, Daniels shows up for work every day knowing the projected 10-year surplus is \$3 trillion. If the current economic slump proves but a bump in the paved road of higher productivity, Bush's economists reckon there will be enough to pay for tax cuts, keep programs growing above the rate of inflation, and still have \$840 billion left over for emergencies. "The [new] budget is conservatively assembled," Daniels insists.

Still, Daniels' role as a spear-carrier



CONSERVATIVE LOYALIST

Daniels was happily toiling at Eli Lilly when the call came

with Al Hubbard, a Bush chum who heads an Indianapolis chemical company, sold the President on Daniels

on the strength of his rep as a conservative loyalist—qualities the Bush crew thinks were lacking in Richard G. Darman, Bush Sr.'s OMB honcho. Darman was an intellectual powerhouse. But his role in pushing the elder Bush to abandon his "no new taxes" pledge made

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for Bushonomics rankles Democrats. "It says something about this Administration that they picked a political guy [for OMB]," says House Budget Committee member Michael E. Capuano (D-Mass.). "Daniels' main job is to pretend that the budget is not going to be negatively impacted by these huge tax cuts."

Sour grapes, say Daniels' defenders. "It's true that Mitch initially didn't know much about the budget," concedes former Reagan Budget Director James C. Miller III of Citizens for a Sound Economy, an anti-spending lobby. "But he's a very fast study and is using his business experience to delegate." Adds Thomas A. Schatz, president of Citizens Against Government Waste, a nonpartisan watchdog group: "I have been very impressed. Daniels has a good handle on issues and is an excellent manager."

He'll need those skills in the months ahead as his job gets tougher. Although budget experts give the OMB chief credit for trying to rein in spending, the Administration's new budget is far from an all-out war on corporate subsidies and congressional pork-barrel projects (page 80). And no one knows whether the Blade will turn out to be a dull penknife when it comes time to confront Defense Secretary Donald H. Rumsfeld's ambitions to add up to \$20 billion to the defense budget.

Like other Republican budget directors, Daniels dreams about reforming entitlement programs. But prospects are dicey, at best. The stock market meltdown has pushed Bush's plans for private Social Security accounts off into the future. And Medicare, which the OMB chief says is "headed for Niagara Falls, financially," could prove tough to revamp. Democrats want a costly new prescription-drug benefit for seniors added to the program, but the White House fears that it won't be able to push through structural reforms if it agrees to this goodie up front.

One area where business expects Daniels to have an immediate impact is

"Mitch was no budget guru. . . just a smart guy we had confidence in," says Bush's Chief of Staff

in choking off the flow of new regulations, something he calls "an immensely important mission." Up to now, he has been reviewing a torrent of last-minute Clinton regulations, many of them seemingly designed to make Bush look bad if he chose to overturn them. "The place was booby-trapped," says Daniels.

In the future, Daniels plans to make OMB a strong filter for proposed regulations that could stifle economic growth. For his chief antiregulatory cop, he has

tapped John D. Graham, director of the Center for Risk Analysis at the Harvard University School of Public Health. Graham is a controversial choice because critics think his Harvard center provides "rent-a-scientist" testimony on behalf of business interests. More important, Graham wants to roll back health, safety, and environmental safeguards, critics charge.

HOOSIER WIT. "Graham's view is paralysis by analysis," says Joan Claybrook,

president of Public Citizen, a consumer organization allied with Ralph Nader. "He will be the instrument of industry, a backdoor entry point for every business that doesn't want to be regulated."

Daniels will try to weather the criticism with his trademark quiet intensity and dry Hoosier wit. "He's a gentle spirit but a tough man," says Bush strategist Karl Rove. Daniels is also not quite the numbers naïf foes make him out to be. At Lilly, he was responsible for strategic planning and directed North American operations, jobs that required a good bit of data sifting. "He has a 60-pound brain in a 120-pound body," enthuses Lilly CEO Sidney Taurel. "He never engaged in groupthink or told me what I wanted to hear."

In his new Washington assignment, Daniels seems determined to escape the Beltway Syndrome and will be doing his slicing solo. He has kept his family back home in Indianapolis and commutes every two weeks for a little family R&R and some golfing with old chums. Says Daniels: "It's a good idea for a budget director to live where people think a trillion dollars is a lot of money."

By Lee Walczak and Richard S. Dunham, with John Carey and Lorraine Woellert, in Washington

MITCH DANIELS

AGE 52.

HOMETOWN Indianapolis.

FAMILY Married; four daughters, 14 to 21.

EDUCATION B.A., Princeton, '71; J.D., Georgetown law school, '79.

POLITICAL

EXPERIENCE Fresh from college, Daniels made a name for himself as an aide to Richard Lugar, Indianapolis mayor and later U.S. Senator (R-Ind.). Served as director of the National Republican Senatorial Committee under Lugar in 1983-84. In the second Reagan Administration, he was political director and head of the White House Office of Intergovernmental Affairs but quit after clashes with Chief of Staff Donald T. Regan.

PRIVATE-SECTOR

EXPERIENCE In 1987, he became COO of the

Hudson Institute, a conservative think tank. Three years later, he joined Eli Lilly, where his last post was senior vice-president for corporate strategy and policy.

HOBBIES Avid golfer. Huge fan of the Dodgers and Redskins.

TOP QUALITIES Smart, politically savvy, blunt, and straight as an arrow.

THE RAP ON DANIELS Insufficient experience on budget matters. Can be caustic at times. Liberals think he's too conservative and too tied to pharmaceutical interests.



EARLY START: Mitch Daniels meeting LBJ at Boys' Nation in 1967

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THE BUDGET

CUTTING CORPORATE WELFARE: IS BUSH SERIOUS?

The most egregious examples have yet to feel the ax

President Bush won the White House in part through the largesse of Big Business, which heavily financed his \$191 million campaign. But Corporate America's support is not being rewarded in the President's first budget. Instead, Dubya's spending plan cuts sacrosanct aid-to-business programs by nearly \$1 billion, drawing blood from Boeing, Ford, Intel, GE, and many others.

Direct government payments to business cost taxpayers an estimated \$300 billion over the past five years. They range from loans to help weapons makers sell arms overseas to grants for researching caffeinated chewing gum. And that figure doesn't include indirect payments through tax breaks.

SOFTBALLS. Government watchdogs seem impressed with Bush's first foray. Says Stephen Slivinski, a fiscal-policy analyst for the libertarian Cato Institute: "I wasn't expecting such an aggressive attack on corporate welfare." For example, to help pay for his proposed tax cut, Bush trims \$22 million from the Partnership for a New Generation of Vehicles, a fuel-efficient car program that benefits Detroit. And Bush would slash \$251 million in funding for the Export-Import Bank and the Overseas Private Investment Corp., which help big names like Boeing, Bechtel, and Halliburton compete overseas.

But so far, the Baseball President has been swinging at softballs. Law-

makers in the past have targeted many of the same items, including the Commerce Dept.'s Advanced Technology Program, which subsidizes research by such giants as General Electric Co. and Bell-South Corp. "There's support to eliminate most of what he has proposed," says Thomas A. Schatz, president of Citizens Against Government Waste, an anti-pork-barrel outfit. "He and his people are very smart. They



didn't want to take on a fight they wouldn't win, at least the first time out.

Office of Management & Budget Director Mitch Daniels says that Bush is following a one-step-at-a-time strategy. But he calls the runup in spending on corporate subsidies "problematic." Adds Daniels: "We'll see what kind of luck we have with [these cuts], then take a look at others."

Once Bush has plucked the low-hanging fruit, he may be under heavier pressure to back off. The really big bucks go to politically powerful agribusiness companies such as ethanol producer Archer Daniels Midland Co., ADM and farmer got a combined \$800 million in tax breaks last year. Another big winner is sugar growers: Federal subsidies cost consumers some \$1.4 billion last year in higher prices.

Bush, whose campaign received \$2.1 million from agribusiness, has avoided painful cuts to the farm industry. His budget leaves intact a \$478 million Agriculture Dept. program to boost overseas sales of U.S. crops. And he actually increased spending for a program that funds advertising for peanut growers, catfish farmers, and others.

Critics cite those programs as among the worst examples of corporate welfare but concede they are the toughest to eradicate because "[they] have such entrenched constituencies," says Representative Paul D. Ryan (R-Wis.). Adds Cato's Slivinski: "Going after the big ones might be difficult at this point." But he thinks that small victories could "embolden the troops" to seek larger reforms. Then will come the real test of whether Bush will put principles before patrons.

By Lorraine Woellert
with Richard S. Dunham, in Washington

WHAT THE BUSH BUDGET CHOPS...

EX-IM BANK Reduces from \$925 million to \$687 million funding for agency that finances purchases of U.S. exports

OVERSEAS PRIVATE INVESTMENT CORP. Cuts from \$47 million to \$23 million funds for low-cost risk insurance for companies in emerging markets

ADVANCED TECHNOLOGY PROGRAM Reduces from \$132 million to \$13 million an obscure Commerce Dept. program that subsidizes tech companies' research

ENERGY R&D Slashes Energy Dept. research programs by over \$300 million, including ones to develop fossil fuels, turbine generators, solar and wind power

...AND WHAT IT DOESN'T

ETHANOL FUEL SUBSIDY This \$800 million tax break subsidizes corn growers, especially in politically powerful Iowa

MARKET-ACCESS PROGRAMS Bush would increase, from \$86 million to \$92 million, funds for such promotional groups as the Catfish Institute and National Watermelon Board

CLEAN COAL R&D It just gets nicked, down from \$2 billion to \$1.9 billion

TIMBER SUBSIDIES Loggers get \$500 million a year to cut trees on federal property

BusinessWeek

Small Biz

How to Beat
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BusinessWeek Small Biz

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Reality Tech

Now that the pace of innovation has slowed a bit, it's a fine time to redefine your business strategy as it relates to technology



Cover photograph by Pej Behdardvand
Photo above by
Jason Grow/Corbis Saba



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Mercadant
and Joyce
couldn't get
bankers to
say "yes"

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UNDER 30

38 Greg Eisen's sports-photo biz is a solid hit

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A supplement of BusinessWeek Magazine
1221 Avenue of the Americas NY, NY 10020

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Wide Open Spaces

BUSINESSES IN THE BOONIES STAND BETTER ODDS

BRIGHT LIGHTS, BIG CITY MAY NOT BE ALL IT'S CRACKED UP TO BE. The typical urban business is 27% more likely to fail in the near future than a similar rural one, says new research from the Small Business Administration's Office of Advocacy. Owners of business-services companies might especially consider a pastoral change: Their companies are 48% more likely to close quickly than their rural counterparts.

Jonathan Brandow, of Camp Hill (Pa.) consultancy **THE BRANDOW CO.**, notes that the competition is often tougher in metro areas. "It's more of a churn," says Brandow. The National Commission on Entrepreneurship's Doris Freedman says higher startup costs in cities could be to blame, along with higher turnover in employment and the difficulty finding real estate. Maybe rural areas really do have fields of dreams, after all.

SO THEY SAY

"If we had hired, we'd be drowning."

—**JODY HAAS**, chairman of Chicago recruiters *Resource Technology Associates*, on how small companies have avoided layoffs (page SB7)

ONE IOTA

IS THAT ALL?

Percentage of fast-growth companies in high-tech or technology-related industries

Data: National Foundation for Women Business Owners

13

Crunching the Number Crunchers

You no longer need green eyeshades to size up a bookkeeper. The American Institute of Professional Bookkeepers now offers a free test to screen bookkeepers, who rarely carry industrywide certification. The 10 multiple-choice queries on each test are randomly pulled from a database of 250 questions. Request a test at www.aipb.org.





Drew Mendoza, president of Family Business Consulting Group, Inc., on SUCCESSION ISSUES

How can entrepreneurs prepare their kids for ownership? They can talk about how much they like their work, even when the children are babies. That it's not just headaches. That the family business gives back to the community. Then they can teach their children how to resolve disputes on their own, so they don't grow up expecting someone else to intervene.

When should kids become owners? That's up to the parents, but the rules for ownership should be clear. You could let them inherit with no strings, or you might require the kids to learn to read a financial statement before they control stock.

What should the children do? Multiple heirs who are interested in the company should caucus on their own. Then they should make a proposal to the parent generation, laying out who will be leading the company and what it will look like. Saying "O. K., Dad, you pick among us" is very divisive.

Ocean Notion

SEA POWER TAPS THE BRINE'S BRAWN

MOST BUSINESS PLAN CONTESTS are hotbeds of capitalism, not charity. Then there's the University of California at Berkeley's Haas Social Venture Competition, which awards B-school students \$10,000 for ideas that show both social and economic responsibility. This year's winner, six-person **SEA POWER & ASSOCIATES**, aims to build a network of floats, pumps, and generators that convert ocean wave energy into electricity. Berkeley student Misha Cornes says Sea Power could give islands clean electricity for 12¢ per kilowatt hour—about 40% less than diesel. Sea Power has already built and tested a half-size prototype. Now it needs \$2.5 million for a full-scale model before it tackles a demo plant in Hawaii in 2004. Cornes has shelved his job search to work on Sea Power and says the uncertainty "is getting a little hairy." But with its Haas win, Sea Power may have caught a wave.



SHORE THING? Cornes (above left) and colleagues have built a prototype for a network of floats, pumps, and generators that turn waves into electricity

AOL's New New Thing: B2B Sites

Who could imagine history would repeat itself so quickly? Following in the beleaguered footsteps of VerticalNet and Onvia.com, America Online says it will add 10 small-business exchanges to its Netbusiness center, starting in the fashion, landscaping, and agricultural industries. AOL says it will succeed because it has the ability to integrate content, commerce, and community. That has won AOL 29 million subscribers, but e-commerce diehards know small biz is a tougher sell. After all, when's the last time you bought a pizza—or hired a consultant—online?

Enough to Make You Ill

RIISING HEALTH-CARE COSTS WALLOP SMALL COMPANIES AND THEIR EMPLOYEES



15% was the average hike in health insurance costs last year

12% of companies may drop insurance because of price increases

45% of small-biz employees contribute to health plan premiums

42% of premium costs are borne by employees in small businesses

Data: National Association of Health Underwriters

A man in a dark suit and blue shirt is lying on his back on a patterned surface. A laptop is resting on his chest, and his hands are clasped behind his head. The background features large, overlapping red and white circles.

I convinced them

we needed a phone system
that's easy to manage
with IP and analog call switching
multi-media call center
and smooth migration

AltiGen Communications
convinced me

Finally a phone system that reduces costs by seamlessly converging the computer, telephone, and Internet. Find out why the editors of PC Magazine ranked us no. 1, visit our Website at www.altigen.com or call 1-888-ALTIGEN. A lot more phone for a lot less.



FRONT

LINE

NEWS
ANALYSIS
IDEAS FOR ENTREPRENEURS

STATS OF THE MONTH

59%

of small-business owners rate President Bush as "good" or "excellent"

55%

of small companies do not monitor employee Web use

34%

of small businesses are "very optimistic" about 2001



ECONOMY

Dodging the Bullet

WHY THIS DOWNTURN MAY NOT HURT SMALL BIZ

BY JANIN FRIEND

HARDLY A DAY GOES BY WITHOUT a new piece of grim economic news. One corporate giant after another warns of earnings shortfalls, often followed by plans to dismiss thousands of workers. Inventories remain high, capital

spending is weak, and many economists warn of a sustained economic swoon. It's enough to send an entrepreneur into a deep depression.

Well, put away the Prozac. While a downturn is never a good thing, there's plenty of evi-

dence that small companies could be spared much of the trauma this time around, especially compared with big business.

True, slowing sales are a problem for all companies regardless of size, and small ones can't hold out indefinitely. But many of the problems that plagued entrepreneurs during the boom may have saved them from even worse pain during this downturn.

Bloated payrolls? Not here. Faced with low unemployment and ever-escalating wages during the boom years, many small companies had no choice but to leave job openings unfilled. As a result, "small businesses are running with much leaner payrolls than they have in the past," says Martin A. Regalia, chief economist at the U.S. Chamber of Commerce.

When the economy was roaring, that was a source of countless headaches. Last year at this time, Jody Haas, chairman of Des Plaines (Ill.) recruiting agency Resource Technology Associates Inc.,

was desperate to hire. But there were no full-timers available. Thank goodness, because in January, business almost stopped. "If we had hired, we'd be drowning," Haas says. Instead, she has eliminated 15 temps and mandated four-day workweeks for the 40 full-timers who remain. While no

one is thrilled about a forced 20% pay cut, the move has been far less costly and disruptive than mass layoffs.

If small businesses didn't over-

hire, neither did they produce warehouses of inventory that now must be worked off. A mere net 1% of companies reported higher inventories in March, says the National Federation of Independent Business, virtually unchanged since January, suggesting that small companies are being spared Corporate America's inventory adjustment.

STRONG CASH FLOW

THE SAME IS TRUE of the shocks caused by the slide in the financial markets. Aside from a tiny number of technology startups, few entrepreneurs received a dime of venture capital, and even fewer financed their growth through public stock offerings. Many small-biz expansions were funded by strong cash flows. George E. Johnson, CEO of Cosmi Corp., a Rancho Dominguez (Calif.) software publisher, spent the past several years resisting offers from venture capitalists and investment bankers eager to take his company public. Instead, over the past five years, Cosmi tripled its revenues to \$25 million, financing the growth entirely through cash flow while modestly increasing its workforce from 50 to 100. "We are

HIS OWN MAN:
George Johnson
wouldn't take
Cosmi public



SMART ANSWERS

Q

I am starting a professional services firm.

How do I

determine how much salary to pay myself?

—S. H., Cleveland

A

When calculating your salary, you'll need to consider a range of factors: the

age of your business, sales and profits, the industry you are in, and where you're based. Try to get a sense of what people in similar circumstances make. Aspen Publishers Inc. (www.aspenpublishers.com) and Western Management Group (www.wmgnet.com) publish yearly compensation reports, though they're

pricey—from \$475 to \$675. Free information is available at places like Salary.com and our own Web site at smallbiz.businessweek.com.

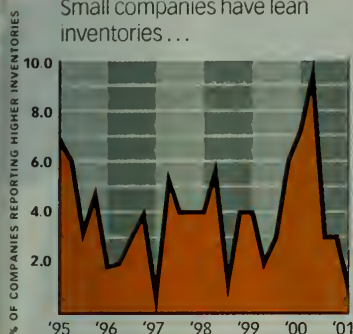
In general, it is rare for a business owner with outside investors to take home more than 50% of the profits. Two exceptions are sole proprietors and owners of S-corporations, who often take as much as 100%. Owners of startups tend to take low salaries, or none at all; after all, you're still building your business. It's a sacrifice, but one that could pay off in the long term. —KAREN E. KLEIN



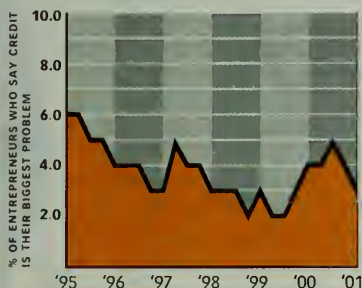
**One
caveat:
Shoppers
could cut
their
spending**

One Dark Cloud

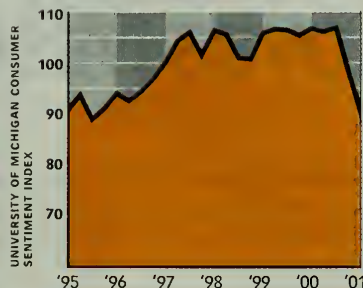
Small companies have lean inventories ...



... and those with a solid track record can still borrow ...



... but consumer confidence is falling sharply



Data: National Federation of Independent Business

lean and mean," Johnson says.

Johnson even balks at bank loans. But if he asked for one, he would stand a decent chance of getting it. In the NFIB's March survey, only a net 3% of small companies said loans were harder to obtain. "Credit for small business is not drying up as much as it is for bigger and midsize firms," says Robert E. Berney, chief economist for the Small Business Administration's Office of Advocacy. Indeed, in the Federal Reserve's March survey of senior loan officers, 43% of respondents reported tightening loan standards for small businesses, compared with 52% for large companies.

Sure, it's encouraging—but not a reason to celebrate. A slump is a slump, and there are signs of trouble: Lenders are getting stingier (page 24), and the NFIB's March survey reports that first-quarter profits and sales fell to levels not seen since the early 1990s.

Perhaps the darkest cloud on the horizon is consumer confidence. If small companies have so far been spared, it's because consumers have continued to buy. That may be changing. In March, retail sales fell by 0.2%. And in April, the University of Michigan's consumer sentiment index sank to its lowest level in seven years. "If consumption goes down, more small

businesses will go bankrupt than large ones," says Wesley W. Basel, an economist with Economy.com Inc., a research firm in West Chester, Pa. "They have the fewest resources to weather the recession."

SMALL AND NIMBLE

THAT HAS CERTAINLY BEEN the case in past slowdowns. But other economists remain optimistic. In the fourth quarter of 2000, for example, as corporate profits were starting to slide, small-business profits were still growing, albeit at a slow 4.7%, says John E. Puchalla, an economist at Moody's Investors Service. Puchalla says that the trend will continue, largely because small companies didn't overreach and won't have to restructure. Small businesses are less exposed to fluctuations in global markets, where a strong dollar is cutting into revenues.

Small-business employment also could hold up, says David L. Birch, an economist and the president of Cognetics Inc., a research firm in Cambridge, Mass. Since the 1980s, Cognetics has tracked employment rates at 10 million businesses nationwide. During the recessions of the early 1980s and 1990s, Birch says, small businesses posted modest job growth, while big-business employment declined. "Small businesses slow down, but they don't drop," he says. The reason: "They have the ability to adapt faster."

Will entrepreneurs be as nimble this time around? Birch thinks so. Small companies may face a series of tremors, but there's a good chance they'll avoid the earthquake.

@SB For more information on coping with an economic downturn, click Online Extras at smallbiz.businessweek.com

How Big Is Your Tax Cut?



How high are the stakes for small business in the battle over President Bush's tax cut? Try **\$75 billion**. That's how much the controversial plan would put in entrepreneurs' pockets, according to a study by **AMI-Partners Inc.** in New York. The survey focused on the approximately 2.5 million unincorporated businesses with fewer than four employees, most of which pay the top tax rate of 39.6%. Under Bush's proposal, about half of those companies would get an average of **\$60,000**, the study says. Sure, the size of the tax cut could shrink before it's passed. But even a modest slice could mean big bucks for some small businesses.

—NAWEEN A. MANGI

WHO'S HOT

Company Loves Misery

DOT-COM MISHAPS ARE PHILIP KAPLAN'S PASSION

PHILIP KAPLAN LEADS a double life. He's the successful, 25-year-old founder of PK Interactive Inc., a New York Web development shop with three employees and big-name clients. But behind the mild-mannered facade lurks Kaplan's alter ego, "Pud," the foul-mouthed proprietor of f**edcompany.com, the notorious Web site dedicated to publicizing the missteps of technology startups and humiliating the managers who commit them.

Kaplan makes no apologies. "Ninety percent of the CEOs I list are liars and cheats," he says.

Since launching in May, 2000, the site has become a New Economy phenomenon—loved by those who relish seeing arrogant dot-commers get their comeuppance, loathed by executives whose stumbles provide fodder for the site.

Thanks to the depth of the tech downturn, as well as Kaplan's caustic wit, what began as a hobby now gets 3.5 million visitors a month.

So Kaplan has decided to give up the double life. In April, he handed over PK Interactive to his three employees. Now he devotes all his attention to the site. Each day, Kaplan receives about 500 e-mails, mostly from dot-com workers detailing goings-on at their companies. He posts only the juiciest and

most plausible. (Some companies have also sent blustery legal letters, but no one has actually sued.) For \$75 a month, readers can search Kaplan's entire e-mail database. He has sold about 800 subscriptions, mostly to data junkies like day traders and journalists. The site also sells ads.

Advertising and subscriptions? Isn't that what spelled doom for so many dot-coms? "It hasn't worked for a lot of sites," Kaplan admits. "But if those sites were smart, they'd be multi-millionaires." Kaplan, who says that the Web site operation and PKI net him over \$1 million last year, is now a sole proprietor with almost no overhead. And what happens when the current wave of business failures ends? Kaplan isn't worried and he's having fun while it lasts, appearing on TV and radio shows and negotiating a book deal. For now, he seems to have discovered an Internet business model that actually works: picking over the carcasses of dead dot-coms.

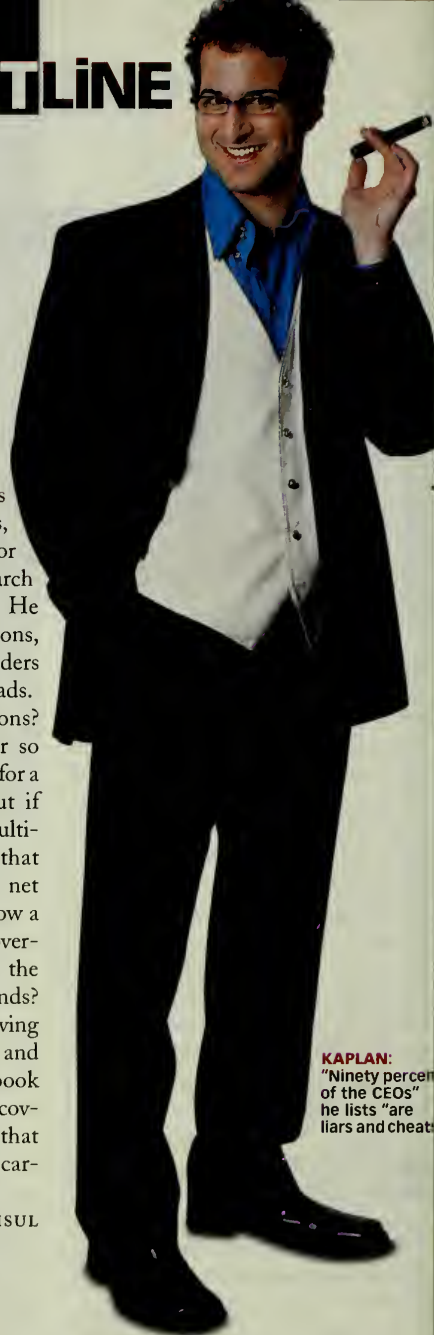
—KIMBERLY WEISUL

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Son of Napster

Music fans are calling it the next Napster: a Web-based tuner that can search some 10,000 Internet radio stations and allow listeners to **record selected tunes** on their hard drives. Launched in March by Santa Cruz (Calif.) startup Audio Mill Inc., the Bitpop Tuner already has more than **100,000 users**. CEO Bill Putnam Jr., 36, expects the 10-person company to avoid Napster's copyright woes. "There is a history of personal recording with VCRs and cassette recorders," he says. What's more, Bitpop downloads can't be shared like MP3 files. The Recording Industry Association of America won't comment, but it has been filing lawsuits in similar cases. Stay tuned. —NAWEEN A. MANG



KAPLAN: "Ninety percent of the CEOs" he lists "are liars and cheats."

AT A GLANCE

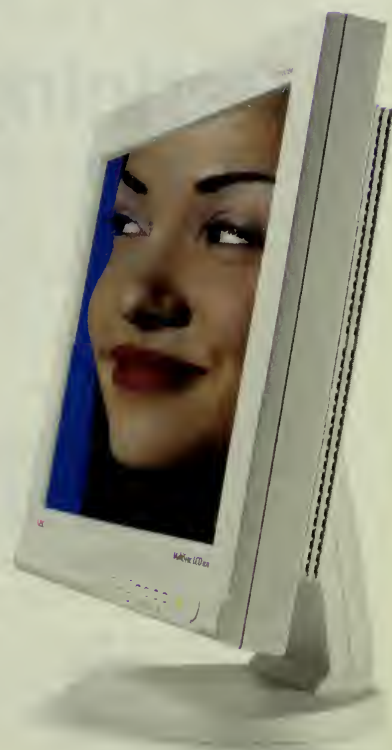
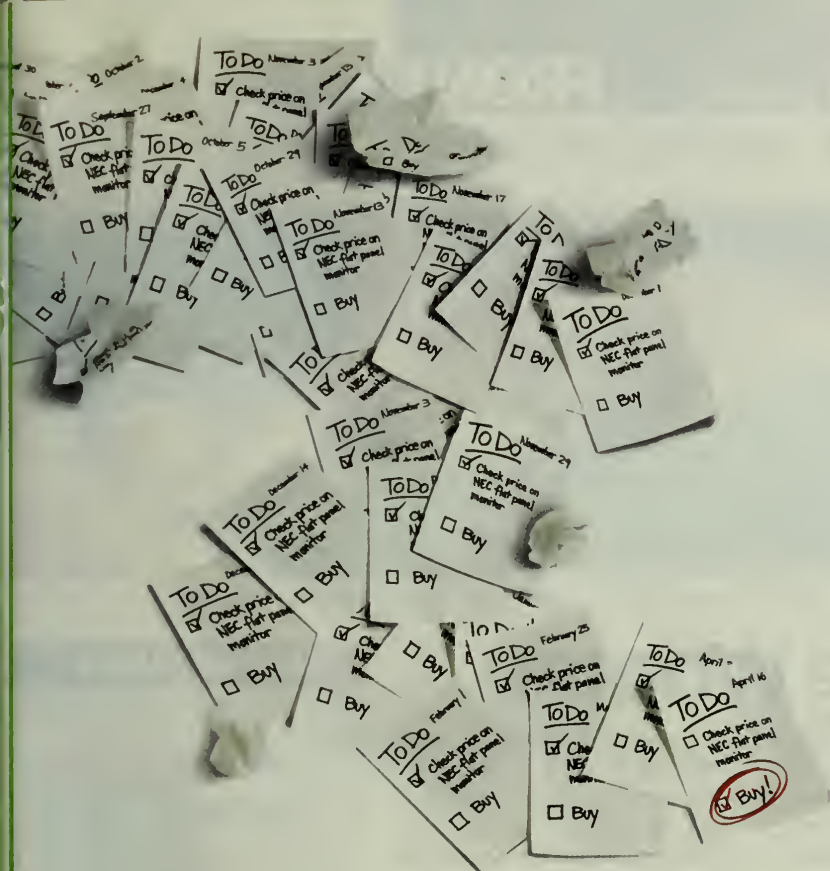
Who: Philip Kaplan, chief executive

Age: 25

Product: Caustic commentary and inside information on dead and dying Internet companies.

The Buzz: Kaplan called the dot-com collapse early. Now he's building a business on it.

NEC



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TRENDS

Defining Women

DOES THE U.S. CENSUS UNDERCOUNT FEMALE ENTREPRENEURS?

THERE ARE 5.4 MILLION women-owned businesses in the U.S., with nearly \$819 billion in annual sales, according to new data from the Census Bureau. With numbers like that, you would expect the National Foundation for Women Business Owners to jump up and yell: "You go, girl!" Instead, the leading advocacy group for female entrepreneurs is grumbling. That's because last May, it released its own stats, showing 9.1 million women-owned businesses.

Why such a big gap? Because different people define "woman-owned" differently. The 1992 Economic Census regarded companies 50% owned by women to be "woman-owned." But the latest report, released in April and based on 1997 data, ap-

plied a new threshold: 51%. The NFWBO, by contrast, counts 50-50 partnerships, as well as companies managed by women that have gone public or sold equity to investors.

Census officials say they adopted the new standard to get in line with the largest data users, such as the Small Business Administration. But groups like the NFWBO say that the narrower definition provides an inaccurate picture. The dispute is far from academic. The federal government, for example, uses the stricter 51% standard when handing out affirmative-action status—one reason, advocacy

groups say, that women's businesses received just 2.5% of federal contracts in 1999.

AT A GLANCE

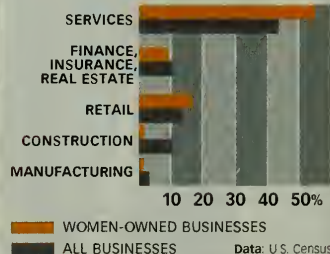
The Facts Women's groups say the Census fails to count the number of women business owners

The Reason Census redefined "woman-owned business"

The Stakes Women fear that lower numbers mean less clout with banks and VCs

Women's Work

Most female business owners are in the service and retail sectors



Both sides agree on one thing: Even with the Census' new definition, the number of woman-owned businesses soared 16% between 1992 and 1997, compared to 6% for all businesses. "No matter what you do with the data, women-owned businesses are growing," says NFWBO Executive Director Sharon Hadary. How much could be a source of debate for the next five years. —JOAN RAYMOND

@SB For more information on women-owned companies, click Online Extras at smallbiz.businessweek.com

NEWS FROM OUR WEB SITE...

SmallBiz ONLINE

VENTURING INTO NEW REGIONS

A program launched by the Small Business Administration aims to steer some venture capital away from the coasts to low-income areas inland. SBA-approved investment compa-

nies will get \$150 million to distribute.

DOWNTOWN IS UP

While Corporate America faces slumping sales, Main Street America is booming, according to a National Trust for Historic Preservation

study of downtown districts. Of the 1,200 businesses surveyed, 56% said sales rose in 2000, 65% said property values rose.

LENDING A HAND

Want to do good by shopping? American Express will donate

1% of spending from a small-biz credit card to fund micro-loans for startups by disadvantaged groups. The card carries a 3.9% initial annual rate.

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CRM SOFTWARE KEEPS YOU AND CUSTOMER ULTRA-COZY

Customer relations improve when all the lines are open

ESCROW PARTNERS INC. was drowning in its own paperwork. "We would work until nine o'clock each night, but we couldn't keep our heads above water," says Michael Stevens, president of the Bellevue (Wash.) financial-services firm. Its best customers, too, were flooded with phone calls, faxes, and letters from the company. "We'd waste 40 to 60 hours a month," recalls Escrow customer Megan Hooker, a transaction coordinator with Rebug Inc., a real estate services company based in Everett, Wash.

Now everyone is breathing easier. Escrow Partners' 30 workers leave at a reasonable hour, and its customers get the answers they need immediately. How? A life raft called customer-relationship management (CRM) software.

What exactly is CRM? The term covers a wide range of applications. Some, like those used by Escrow Partners—Commence Corp.'s Commence RM and Allure 2000—make communications easier both inside a company and with outsiders. For Escrow Partners, that means all paperwork involving owners, sellers, brokers, mortgage companies, and insurers is funneled to its Web site, which automatically e-mails all concerned whenever a change is made to an account. Other CRM programs, like UpShot Corp., serve more as an internal communications

RANDOM access



CLICK TO PRINT

Tired of trekking to your commercial printer? Mimeo.com offers quality print services over the Net. On your PC, you just select "Mimeo" as the printer option. Mimeo will ship finished documents. Prices start at 14¢ a page.

E-PAYMENTS, B2B



Pitney Bowes Inc. now offers business-to-business escrow and credit services for .4% to 1.75% of each transaction (pitneybowes.com).

VeriFone Inc., a Hewlett-Packard Co. subsidiary, has a system that works with fixed and mobile Internet devices (verifone.com). Rates vary by the number of merchants and transactions.

BACKUP WITH A TWIST



What distinguishes CompanyDrive's Net backup service? Files are accessible with any Web-connected Palm device or cell phone, there's file sharing, and Internet files can go directly into your CompanyDrive Web space (companydrive.com). Prices start at \$100 per gigabyte per month.

tool, enabling sales reps to keep closer tabs on their accounts—and managers to keep closer tabs on the reps. All told, several dozen vendors sell CRM products for small business.

Whatever the program, the aim is to improve relations with customers. How does it work? Take Commence RM. Say your customer bought a dozen Palm Pilots from your Web-based electronics store, only to find five have broken screens. At your Web site, she fills out an electronic service ticket that's part of the CRM program. The ticket is routed automatically to an account file that's available to the service,

sales, and shipping departments—each of which is alerted when it arrives. Service arranges to replace the units and sends the customer an e-mail; the sales rep in charge of the account apologizes profusely; and the shipping department sees who has been using its carts for soccer practice. Meanwhile, the customer can check the progress of the order any time on the site.

Mind you, you get what you pay for. Low-cost CRM software (typically running \$5,000 to \$15,000 in annual license fees for 10 users) lacks the power of pricey applications (\$1,000 to \$5,000 per user). The high-end stuff, sold by Siebel Systems Inc., PeopleSoft Inc., and others, allows major corporations to seamlessly handle huge volumes of inquiries from the Net and phone simultaneously, and caller ID is linked to customer records.

There are also some midrange alternatives. Multiactive Software Inc.'s Entice!, for example, allows businesses to fully integrate customer communications with back-office applications, such as billing and accounting. Even mid-range CRM software isn't cheap, however. "By the time we're done implementing Entice!, it will have cost us \$100,000," says Ben Hume, president of Alco Ventures Inc., a \$10 million screen-door manufacturer based

in British Columbia. In the end, though, Alco will have integrated order-processing, manufacturing, and retail computer systems. That means retailers such as Home Depot Inc. will always know what products are available and get sales leads when the system forwards the names of consumers who register at the Alco Web site.

Getting your hands on CRM software has never been easier. Several publishers, including Salesforce.com, UpShot, e-Resolve, Commence, and Multiactive Software, offer software hosted on their servers for a monthly fee. It's only worth considering, of course, if you have a high-speed Internet connection—and if the application service provider your publisher has partnered with isn't heading for bankruptcy. If either your Internet connection or your confidence is shaky, remember that many publishers, including Multiactive Software, Commence, and e-Resolve, also sell some of their products on CD-ROM.

Don't relax just yet, though. The real fun—implementation—is about to begin. Most small-business CRM software users say it takes their information technology workers a few days to install the programs and iron out any wrinkles. Not bad. But if you plan to integrate common database applica-

JUST BROWSING



THE SITE: SalvageSale Inc.

WEB ADDRESS: www.salvagesale.com

WHAT'S THERE: An auction site for damaged and discounted goods—from computers to Sheetrock.

WHAT'S GOOD: Each bid has an assigned broker to help with problems like glitches in closing a transaction.

WHAT'S NOT: Sellers have to put up goods worth at least \$5,000 for auction. Buyers may find the categories they're interested in empty. And hey, some of the stuff is damaged.

tions, it may take a little doing. Consider, for example, Microsoft Corp.'s bCentral Customer Manager, the newest—and, at \$29.95 per user per month, by far the least expensive—CRM product on the market. As with some rival programs, if you want to tap into Intuit Corp.'s QuickBooks, you must first transfer data to Microsoft Excel before importing it into bCentral Customer Manager. Others, such as Multiactive's Maximizer Enterprise 6.0, provide software that links the CRM program with the database so they update each other automatically.

If you plan to integrate more complicated programs, you may want to put off your vacation. Case in point: Alco Ventures, which has spent eight months integrating Entice! with order-processing, billing, and other back-office applications, won't be done until early next year, says Hume.

A lot of work? You bet. But when all is in place, you'll see your business from your client's perspective—which is what customer relations is supposed to be about.

—KEVIN FERGUSON

@SB Want more advice on choosing the right CRM software? Click Online Extras at smallbiz.businessweek.com

a Related Development...

recent offerings in customer relationship management software

PUBLISHER	FORMAT	PRICE BASE	COMMENTS	BENEFITS
Central Customer Manager (Microsoft)	Web-based, hosted by Microsoft	\$29.95 per user per month	Released in April as part of a suite of bCentral products.	Capture leads via the Web. Keep a Web-based profile of customers.
Commence CRM (Commence Corp.)	CD-ROM	\$695 per user license	Developer spun off from Bell Labs. Profitable and in its 12th year.	Help sales, marketing, and service departments share data.
Maximizer Enterprise 6.0 (Multiactive Software)	CD-ROM	\$199 (\$149 downloaded from Multiactive) for core product	Track sales leads and customer history.	All account data can be kept electronically in one file.
Salesforce.com (Salesforce.com)	Hosted by service provider	\$50 per user per month	Primarily a sales-force automation (SFA) system.	Good for mobile sales reps, but any employee can use it.

CLOSEUP

The Real Stars Sweat Out the Strike Talks

HOLLYWOOD'S SECRET: IT'S A SMALL-COMPANY TOWN

A STRIKE BY HOLLYWOOD'S actors and writers wouldn't have much effect on Lyle Waggoner, the actor. Although he was famous in the 1970s as a cast member of *The Carol Burnett Show*, he doesn't act much these days.

Lyle Waggoner the entrepreneur, on the other hand, would be in big trouble. In 1979, the performer put his acting career on hold and launched Star Waggoners Inc., which leases trailers to production companies that keep talent comfortable on location shoots. The 40-foot trailers cost about \$100,000 and are appointed with plush carpeting, leather easy chairs, and satellite televisions, which makes them popular with TV stars such as Martin Sheen of the *The West Wing*, real Presidents such as Bill Clinton (who leased one for his 1996 swing through California), and pop icon Madonna. A prolonged strike, says Waggoner, 66, could shut down his Sylmar (Calif.) company, idling his 50 employees and taking a bite out of his \$12 million in revenues.

"I just hope the actors and writers don't get too greedy," he says.

It's one of the entertainment industry's untold stories:

For all the attention lavished on studio moguls and A-list stars, Hollywood is a small-company town powered by largely unknown entrepreneurs. Nearly 99% of the 12,000 companies that

make up the motion picture and television industry have fewer than 100 employees, and nearly three-quarters have fewer than four.

'INNOCENT BYSTANDERS'

YET THESE SMALL businesses have no input in contract negotiations between the studios and the Writers Guild of America and the Screen Actors Guild. The talks revolve around difficult issues of residual payments and intellectual property. (At press time, the writers were said to be close to a deal.) "We're innocent bystanders," frets Howard Brock, a partner at Matchframe Video, a Burbank (Calif.) post-production house with 75 employees.

Already, entrepreneurs on the front end of the production process, such as casting directors and prop companies, are seeing their work disappear. Waggoner says it's only a matter of time before the trailers start stacking up at his storage yard: "We're expecting a major slowdown."

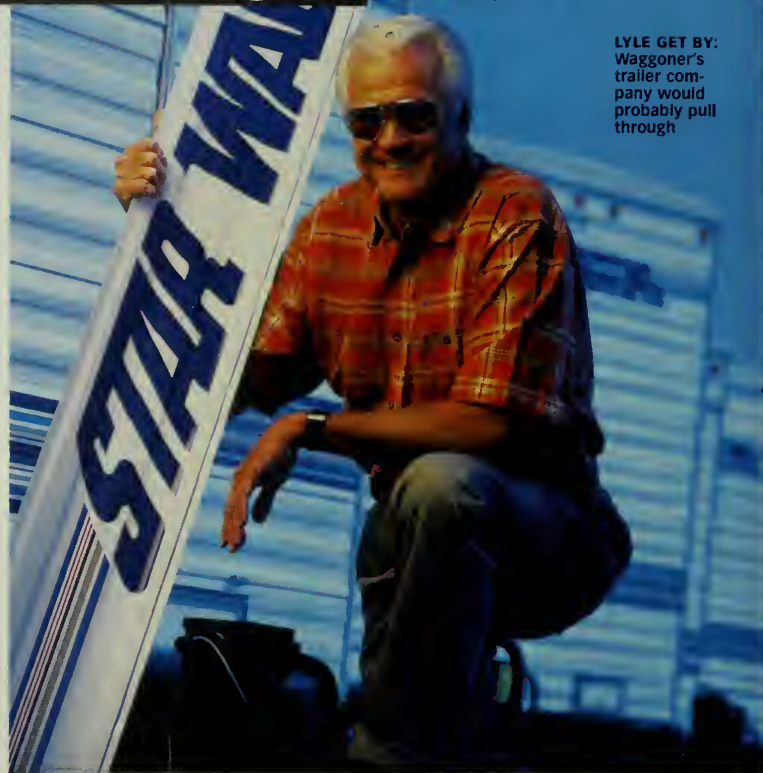
Of course, Waggoner is used to uncertainty, because the life of a small-business owner in Hollywood often resembles that of an actor. For

ingenues and entrepreneurs alike, show biz is a tough road. "It's a feast-or-famine business," says independent producer David Blocker, who recently produced the Robert De Niro vehicle *15 Minutes*. "We're all used to it."

Strikes are just another part of the landscape. Over the past 50 years, actors and writers have struck about half a dozen times each—most recently in 1988, when the Writers' Guild walked out for more than five months.

Waggoner made it through that one, though many of his competitors didn't. A study by the Los Angeles mayor's office found that even a brief, two-month strike in 2001 would cost the city 47,000 jobs and \$2.5 billion in lost income. But Waggoner figures he'll pull through. The television production season is wrapping up anyway, and his employees need to get his 300 trailers in shape for the next season. "Strike or not, our people will be working very hard," he says. Clearly, entrepreneur is one role Waggoner has nailed. —CHRISTOPHER WOODARD

LYLE GET BY: Waggoner's trailer company would probably pull through



"I hope ... actors and writers don't get too greedy"

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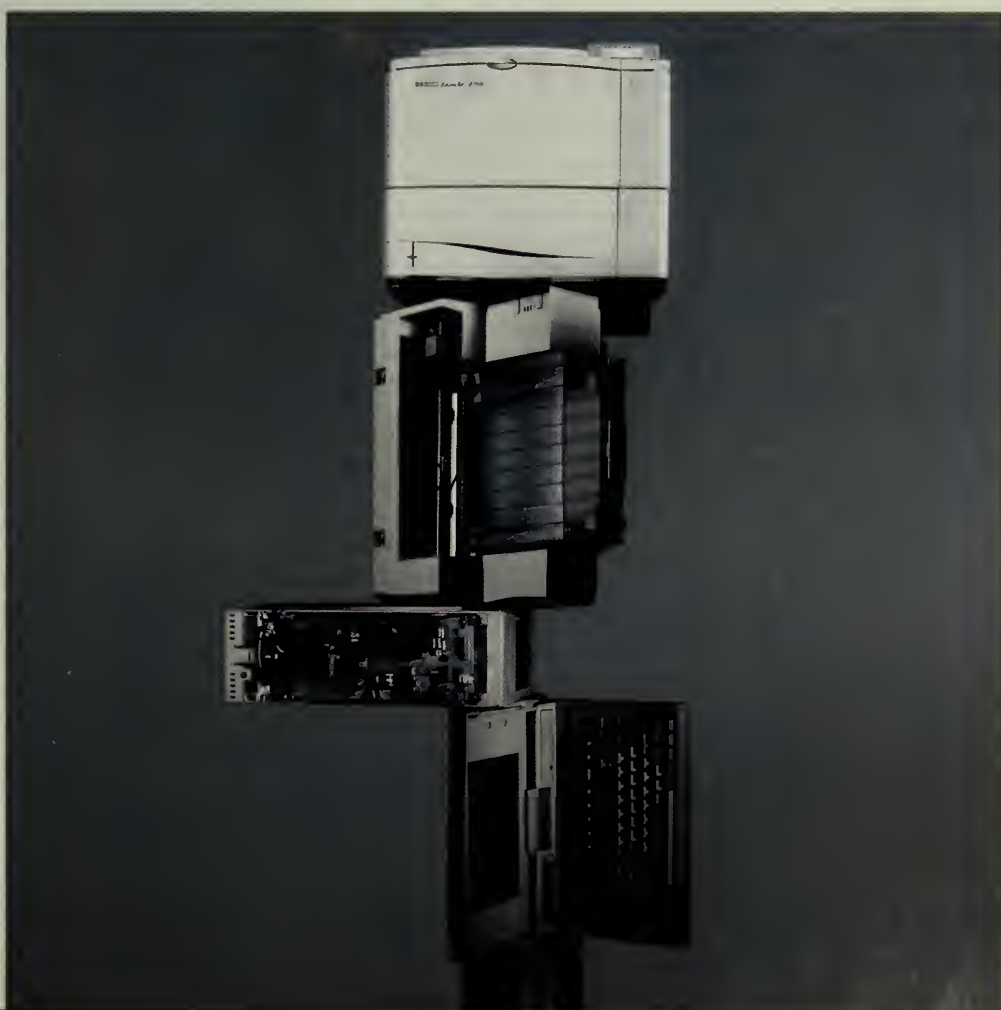
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LIGHT TOUCH:
Meeker's
approach is to
"maintain the
relationship"

WHAT WORKS

Make Them Pay

HERE'S HOW TO COLLECT FROM DEADBEAT CLIENTS

JOHN MEEKER FELT it might take a miracle to collect the \$30,000 his client, a premier educational-technology company, owed his Minneapolis executive-search firm. For several months, Meeker sent out new bills, attaching them to the unpaid ones. After 60 days, he began adding interest. Six long months passed before Meeker had his money. "My strategy is to maintain the relationship," he explains, "so I use a light approach."

In good economic times, late-paying clients are one of the headaches of doing business. But during a downturn, when sales slow, delinquent accounts can quickly turn into cash-flow killers. The challenge is to collect without alienating customers.

The first step to effective collections is prevention. Ask all clients to sign a contract that spells out payment terms and obligations. If deadlines aren't met, renegotiate. Allow clients to pay in installments, or create incentives for people to pay promptly. Meeker, for example, often gives a 5%

break on the third and final installment if payments arrive on time.

If you're still having no luck, take your complaints higher up the chain of command. "Go to the account manager or the CFO," says Theodore M. Dunn, a Mahwah (N.J.) management consultant. Threaten to charge interest on overdue invoices, or have your lawyer draft a letter. (Keep a written account of all verbal communications, too, in case you do end up in court.)

The last resort is a collection agency or lawsuit. Attorneys and bill collectors work on a contingency basis—usually 20% to 50% of the amount they collect, depending on how much money is outstanding and how difficult it will be to get it. Don't count on keeping customers that you've turned over to collections. But you don't want them anyway. Sometimes, the cost of doing business is just too high.

—KAREN E. KLEIN

@SB Want more advice on getting deadbeat accounts to pay up? Click Online Extras at smallbiz.businessweek.com

INSTANT EXPERT



MEDIA RELATIONS

Cultivating good relationships with the media is important for small businesses. But bad press can sting, if you don't know when to say "no comment."

CASE IN POINT

Alan Robbins, president of **Plastic Lumber Co.**, a 50-person recycled-plastics maker in Akron loves to see his company's name in print. So last year, when a national newspaper asked to interview one of his managers, Robbins said O. K. Unfortunately, the employee revealed his salary, which is supposed to be confidential. "There were a lot of hard feelings among other workers," Robbins says. Now, Robbins handles all press inquiries. "You never know what's going to come back and bite you."

RESOURCES

About.com has a section (www.publicrelations.about.com) featuring free articles and links to online resources. Publicity Hound (www.publicityhound.com) offers guides on subjects like damage control and interviewing for \$7 each. For a look inside a journalist's head, check out *Mediasmart: How to Handle a Reporter by a Reporter*, by Dennis Stauffer (Minneapolis Press, 1994, \$19.95) or *Bulletproof News Releases: Help at Last for the Publicity Deficient*, by Kay Borden (Franklin-Sarrett Publishers, 1995, \$18.95).

—JOAN RAYMOND

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MY COMPANY

Sure, I'd Love to Donate!

WHEN A BIG CUSTOMER PLAYS FUND-RAISER, IT'S HARD TO SAY NO **BY KEVIN KELLY**

I'VE LEARNED A LOT ABOUT THE WORLD working in my family's plastic bag manufacturing business, but one of the most startling lessons has been about politics—political fund-raising, to be exact. My education began four years ago, when a large customer called and asked us to contribute to a candidate running for office—in another state. My brother, sister, and I debated the merits of the request. After all,

we knew little about the candidate and nothing about the issues driving the race. In the end, we sent a check.

Why? Well, how do you say no to an important customer? Certainly we worried that if we declined, we might drive a wedge between ourselves and a company vital to our financial health. And it's just such fears that fund-raisers and their political allies must count on when they send out letters asking for a helping hand.

I wonder if the politicians who benefit from our contributions care that we often act more out of concern for our customer relationship than their particular ideas or positions or abilities. Probably not. Still, it must be one of the strange little secrets of politics that at least a portion of the funds raised for each election are produced by customers putting the heat on their suppliers.

I can't say I resent the intrusion as much as I find it curious. I always, naively, assumed that candidates raised money by tapping the pocketbooks of true believers and companies or groups that had some immediate reason to be interested in their help. But with the cost of political campaigns skyrocketing, there is little wonder why candidates and their backers try to cast the widest net possible. While leaning on your suppliers for dough smells of extortion, it's also true that if my customer believes deeply enough that the candidate will help their business, well, then that politician should benefit my little company, too.

This kind of fund-raising has played out often enough now to become a trend. We've contributed to the coffers of a Cal-

ifornia gubernatorial candidate, a congressman who represents the district where most of our customers are based, and a state assembly hopeful favored by another customer. Between personal and corporate contributions over the past three years, I've given about \$5,000 in \$500 and \$1,000 blocks.

In each case, for one reason or another, the individual was agreeable to us. For instance, the congressman, Sam Farr (D-Calif.), represents the Salinas Valley and has crafted law—including laws encouraging organic farming—that have boosted agriculture in California. Since we sell most of our packaging to produce growers, Farr's legislative bent has been good for us, too.

This trend in fund-raising isn't without precedent. Certainly it's a cousin of the long-standing corporate practice of hitting up suppliers and employees for contributions to charities, like those often high-pressure annual United Way International appeals. I truly resented those when I was an employee, since I already gave what little discretionary cash I had to my favorite charities. But now I find myself putting the arm on people, too. Just last month I began writing to our local suppliers asking them to open their wallets to help create an endowment for our public high school district that will be used to fund extracurricular activities like football and the arts.

What would we do if we were asked to support a candidate or cause we found odious? Good question. The fact of the matter remains that, armed with their financial cudgel, the customers clearly have the upper hand when they come asking for money. That's why I suppose they make such effective fund-raisers. Fortunately, so far, our customers are moderate enough—and smart enough—to choose candidates that we can find some appeal in. If the day comes that they're not—well, that's one business decision I can put off without causing any harm.

Kelly is an officer of Emerald Packaging Inc. in Union City, Calif. Do you give campaign cash? E-mail us at smallbiz@businessweek.com



**Pols don't
get all
their cash
from true
believers**

The image features a dense arrangement of numerous small, identical analog watches in the background, creating a sense of repetition and scale. In the foreground, a single watch face is shown in a close-up, detailed view. The watch face is white with black Arabic numerals from 1 to 12, and black tick marks for minutes. The hands are black, with the hour hand pointing between 10 and 11, and the minute hand pointing at 10. The text "Tick...tick...tick...tick..." is superimposed over the background watches in a white, sans-serif font.

Tick...tick...tick...tick...



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Discover What's Possible



Rolling the dice:
Green of Paradigm Learning plays Strive to Drive with middle schoolers in Tampa. The game prepares them to be car owners

MAKING YOUR MARK ON education

BY STEPHANIE B. GOLDBERG

BY TEAMING UP WITH SCHOOL DISTRICTS, BUSINESSES CAN HELP IMPROVE THE LOCAL WORKFORCE—AND LEARN A THING OR TWO THEMSELVES

STARTING THIS FALL, more than 45,000 Florida high schoolers will roll the dice on an amusing board game with a serious purpose. Called Strive to Drive, it takes students through the process of choosing, financing, and insuring a car—and earning the bucks to pay for it.

A Milton Bradley classic? Hardly. The game is a gift to the state's schools from Paradigm Learning Inc., a 45-employee developer of corporate training games in Tampa. Chief Executive Raymond D. Green and his staff spent six months and \$80,000 developing this money-management exercise, which is intended to help students meet new

state education standards preparing them for the work world. Then, Green turned the rights to the game over to a not-for-profit state education group. As a consultant to many blue-chip corporations, Green has heard plenty about their problems in hiring qualified workers, and he wants to help: "If we can take care of our young people's education now, it's going to be better for all of us in the future," says Green.

In Little Rock, Allegra Print & Imaging, a 10-employee printing company, is making a more modest but still valuable contribution to one junior-high and two elementary schools. Husband-and-wife owners, Darwin and Lisa Buehler, are short on free time, but they help the schools conserve their scarce cash by offering free printing services for newsletters, stationery, and directories. Lisa Buehler also fund-raises for the schools, pops over for storytelling sessions, and leads the kids on tours of her business. "The biggest satisfaction of doing this work is the enjoyment and knowledge students gain from it," she says. She has gained in other ways, too: The extra exposure for her printing services has brought in about 30 new clients.

As politicians bluster and educators struggle over the best way to improve the nation's schools, a growing number of entrepreneurs are quietly doing their part. Motivated by both a pragmatic need for a qualified workforce and a desire to fulfill their own sense of social responsibility, they're teaming up with local school

systems in ways as varied as the companies themselves.

The extent of small-business involvement is best revealed in a survey just released by the National Association for Partners in Education Inc., an Alexandria (Va.) clearinghouse of information on such programs. The report shows that small business partnerships with schools have outpaced the number of programs at mid-size and large companies. In 2000, small companies with 50 employees or less accounted for 76% of the business-school partnerships, up from 41% a decade ago. What's more, the survey says, small companies now run a close second to parent-led groups in the number of school partnerships they've formed.

Meanwhile, the role that small business can play in improving the schools is attracting attention in Washington. In an effort to help new graduates make a smoother transition into the workforce, the Senate Committee on Small Business has commissioned a new General Accounting Office report on the best working examples of partnerships between schools and small businesses. Hearings will take place in September. "Small businesses in particular have a tremendous stake in our nation's educational system," says committee Chairman Christopher S. Bond (R-Mo.). Without a well-qualified workforce, small companies can't grow and prosper. And without good schools in their communities, it's harder to attract top employees.

Fortunately, entrepreneurs have a lot to offer the schools, proponents of school partnerships say, particularly in the realm of career development. For one, entrepreneurs can serve as valuable role models for students. Also, small-business internships can often give students a broader and more varied experience than they would get in a large corporate setting. "When you consider the wealth of expertise that lies with small business, the learning potential is enormous," says Darla Strouse, executive director of corporate and foundation development for the Maryland Education Dept.

Unlike traditional charity or volunteer work, a business-school partnership is just what the term implies: a mutually beneficial relationship. The school gets access to your valuable resources—your expertise, your time, and maybe your equipment. And if your company manages to achieve a higher profile and a little marketing bounce out of the association, that's perfectly all right. Want to get involved? Patience is a prerequisite in dealing with school bureaucracy. But persistence can pay off. Here's a lesson plan from entrepreneurs who have already done their homework:

Take the initiative. Now is a good time to begin planning for fall programs. Most school districts have partnership or volunteer offices to

Do Your Homework

To learn more about how your business can work with your local school system, try these resources:

■ **The Business Coalition for Educational Reform.**

www.bcer.org 800 787-2848. National, state, and local business groups seeking to improve schools. Some are more policy-oriented, others provide schools with resources. Use the "State and Local Coalitions" search engine to locate groups in your state.

■ **The National Association for Partners in Education Inc.**

www.partnersineducation.org 703 836-4880. Helps school districts and other organizations set up and run partnership offices.

■ **The National Employer Leadership Council.** www.nelc.org 800 360-NELC. A resource for employers interested in creating work-based educational initiatives such as internships. Use the "Employer Models" search engine to locate programs in your state and in specific industries.

■ **The National School-to-Work Learning & Information Center.** www.stw.ed.gov 800 251-7236. A joint project of the Labor and Education Depts. that works with local communities to help prepare students for the workforce. Use the "Resources" search engine to find articles on effective state programs.

■ **The Education Dept.'s Partnership for Family Involvement in Education.** www.pfie.ed.gov 800 USA-LEARN. Provides support and acts as a clearinghouse for educational partnerships. Use the "Partners" search engine to locate local programs.

coordinate these programs, but they seldom have time or resources to do outreach, says Susan Otterbourg, a Durham (N.C.) education consultant. Call your school district, Chamber of Commerce, or local school-to-work program (table), and set up an appointment. You may also get in touch with an individual school directly.

Be straightforward. Present the school or school district with a list of your resources, and be candid about what you can and can't do. Schools don't mind if there's an incidental marketing benefit. That means it's O.K. to donate a product that has a company logo, but you should avoid transparent marketing schemes, such as handing out coupons or doing a product pitch in class.

Demand accountability. If you're contributing equipment or money, you have the right to know how your gifts are being utilized. "If you give a computer, you ought to know who is using it, how often, and for what," says Otterbourg.

Leverage your products and expertise. You don't have to spend a lot of time or money to make an impact: Just use your resources creatively. For example, software developer Decision Support Inc. in Matthews, N.C., supplies one of its execs for two hours a week each semester to teach computer classes to recently arrived immigrants at the nearby Independence High School in southeast Charlotte. In White Marsh, Md., Bill Wallace, CEO of Action Business Systems, a \$15 million-a-year office-equipment dealer, gave \$200,000 worth of computers and fax machines to 12 Baltimore magnet schools to launch a virtual mentoring program he calls "Fax of Life." Then, he rounded up 75 professionals to answer students' questions on careers via fax and e-mail.

Treat a partnership as seriously as any client relationship. Schedule activities during office hours. At Paradigm Learning, some staffers balked at devoting work time to the project. "My response was that if we don't make this a priority—and only work on it when we have down time—we're not really giving anything," says Green. Another approach: Make participation voluntary. Give extra credit to employees come review time.

Manage the partnership. Good follow-through is essential, so put someone in charge. For example, over the course of nine years, the 70-employee Northeast Bank of Minneapolis has helped the inner-city Holland Elementary School build a playground, equip a computer lab, and enjoy music lessons and live performances by the Minnesota Orchestra. One key to the partnerships' success is the commitment of bank President Belva Rasmussen, but she credits Suzanne Sjoselius, vice-president for marketing, with keeping the program on track. Sjoselius stays in close touch with the teachers, sits on a school governance com-

mittee, and ensures there's a steady flow of bank volunteers to read to the students every week.

Ramp up slowly. Let the partnership evolve as your company and the school work together. When Tutor.com, an online tutoring service in New York, formed a partnership last year with the Choir Academy of Harlem, the home of the famed Boys Choir of Harlem, CEO George Cigale's first step was to donate \$10,000. Those funds were used to buy laptops to keep touring choristers up-to-date on their studies. Gradually, the relationship has inched into the classroom, where staffers have done class presentations and provided some tutoring. Cigale mentors the school's juniors and even did a stint as principal for a day to observe administrator's challenges.

Give and receive. Cigale freely admits that his company is gaining as much as it's giving. Tutor.com's employees have been inspired and motivated by the experience—and Tutor.com has raised its profile within the education community. However, like most other entrepreneurs, Cigale isn't just in this for the good P.R. The real payoff will come later, when today's students make the grade in the world of work.

@SB For more information on setting up a school partnership program, click Online Extras at smallbiz.businessweek.com



ROAD RULES: Strive to Drive got favorable reviews at many schools

The Credit squeeze

Sure, loan rates are a bargain, but what if you can't get one at any price?

BY NAWEEN a. MANGI

SIX MONTHS AGO, BRIAN SCHINDLER EMBARKED

on a money hunt to finance a move to bigger quarters. He figured he would have no trouble getting a \$250,000 loan. After all, Pace Elevator—his 20-employee New York company that installs, modernizes, repairs, and maintains elevators—had been around for 17 years. Its revenues were \$2 million last year, up from \$500,000 when he bought it in 1997. "It's a viable and growing company," says Schindler.

Schindler never expected to have the doors closed in his face by the same two

COVER STORY

Small Biz BusinessWeek



BY MICHAEL
Schindler's loan request was turned down by two banks that had earlier given Pace Elevator \$100,000 credit lines

banks that had extended him \$100,000 credit lines in 1999. Their reason: The slowing economy. "All of a sudden, policies have become a lot more stringent," laments Schindler.

SAY GOODBYE TO EASY MONEY. Welcome to a world of tighter, if more realistic, credit. During the economic boom of the '90s, lenders aggressively courted small companies. "Before last summer, banks were all go-go and less discriminating on underwriting criteria," says Stephen E. Roulac, a San Rafael (Calif.) financial consultant. Non-bank lending mushroomed, and venture capital flowed abundantly into small startups. At first glance, it even appears the Federal Reserve has made conditions easier by cutting the federal funds rate four times this year. Banks in turn have reduced their small-biz lending rates. The average rate for loans under \$100,000 fell to 9.45% in the first quarter, from a peak of 10.36% last summer.

But lower rates don't help if you can't get a loan—and there's mounting evidence that small-business lenders are getting a whole lot pickier. A sampling:

- Standards are getting stricter. The Federal Reserve's March, 2001, survey of senior loan officers showed that 43% of domestic banks had imposed tighter lending standards for small businesses since January, vs. 10% in the January, 2000, survey, and just 4% in January, 1999. Also in March, 48% of banks reported charging higher spreads on high-risk loans, vs. 22% in January, 2000.

- Lenders are demanding more collateral. Phoenix Management Services, a Chadds Ford (Pa.) turnaround man-

in 1999 was suddenly demanding personal guarantees, personal property, and company assets as collateral. "This kind of treatment is simply intolerable," says Gary Carty, chief operating officer of Pixius, who had a 15-year relationship with the bank.

- Approval rates are dropping. Lending officials, including Richard Tambor, senior vice-president for lending at American Express Small Business Services, say that more loans are being denied industrywide. Indeed, the Phoenix report found that 70% of lenders surveyed in the first quarter expected their small-business lending to drop over the next six months, vs. 39% last year.

- Credit-card use is rising. In yet another indicator that entrepreneurs are feeling the credit pinch, NFO World-Group in Greenwich, Conn., says 10% of small-business owners expect to use personal credit cards for business expenses this year, compared with 4% in 2000.

HOW WORRIED SHOULD YOU be about these trends? That depends on your business. So far, members of the National Federation of Independent Business, which tend to be more established businesses, aren't troubled by tighter credit, judging by NFIB's March survey. Just 3% ranked it a top concern. "Banks may have raised the bar. But we're still able to get over it," says William C. Dunkelberg, NFIB's chief economist. Companies with strong financials and long track records will fare best during this credit squeeze, but they'll still need to make a strong case for how they plan to use the loan (page 30).

You're more likely to get your banker's cold shoulder if you're a startup, if your cash flow is spotty, or if you're in a

BYE-BYE, easy money

agement company that does a quarterly survey of credit conditions, says that, on loans of \$1 million to \$5 million, 42% of lenders planned to increase their structural requirements, which include collateral, up from 18% last year. For loans under \$1 million, 36% planned to tighten up, vs. 24% last year. Consider Pixius Communications, a wireless broadband company in Wichita, which sought a \$500,000 loan last summer. The same bank that had lent it \$750,000

slow-growth or troubled industry. Quirky business propositions that might have intrigued a lender in flusher times aren't as likely to get funded now either. For instance, Mark Mercadante, president of Dante Builders, a land development company in Oxford, Mass., has been trying for more than a year to raise \$2 million to develop an upscale designer cemetery with lush gardens and stylish atriums. He and his partner in the project, neighbor and longtime friend



VEXED: Marks lost a loan to smooth Native Nits's cash flow—because that flow was iffy

For the small or **QUIRKY**

Timothy Joyce, called on two banks and a mortgage company last year to no avail. So Mercadante focused instead on finding some willing investors. "Most banks don't have the experience of dealing with projects like this," he says.

It's not just banks that are pulling in the welcome mat. Two nonbank players disappeared from the small-biz lending scene entirely: Boston's PrimeStreet Corp., an online broker, went bust in March, and in February, Heller

Financial Inc. in Chicago, until recently one of the biggest small-business lenders in the nation, dropped out, saying it couldn't meet growth and profit goals.

For many entrepreneurs, it makes sense to combine debt and equity financing. But venture capitalists and angel investors are growing cautious, too. Just ask Lisa Hammond, president of Femail Creations, a \$6 million company in Las Vegas. In 1999, she got a \$750,000 Small Business



ON HOLD: With equity financing short, Femall's Hammond put off expansion

Administration loan that helped her expand her mail-order sales of women's clothing, jewelry, and home accessories. Last year, she was ready to double her catalog's circulation but needed a further \$3 million to \$5 million. Hammond had as much debt as she could handle, so she was hopeful when investors approached her. But they all backed out after Nasdaq's April, 2000, collapse. "We were disappointed because this year was going to be our big push," she says. Instead, she's put the expansion on hold.

When major banks and investors turn you down, you could try your local community bank. That's how Pixius' Carty finally managed to borrow \$250,000. But borrowers should expect to pay higher rates—about half a point more than at a big domestic bank, according to Fed data.

Some entrepreneurs can find loans through specialized bank lending programs with more flexible terms. Last year, Sandra Marks and her husband, George Joseph, went to their bank for a \$100,000 loan to expand their \$500,000-a-year Long Island

City (N.Y.) knitwear import business, N8tive Nits Inc. "They told me I didn't have the cash flow to qualify," Marks says. "What can you say to that—when that's the reason we were trying to get a loan in the first place?" Finally, she landed an SBA-backed \$100,000 loan last September through FleetBoston Financial Corp.'s Women Entrepreneur's Connection, part of its specialized-lending unit. Warren Krug, vice-president and SBA sales executive at Fleet, was impressed by Marks' client roster. "She brought in catalogs of blue-chip companies who were selling her products, and I had the confidence she could grow and expand her company."

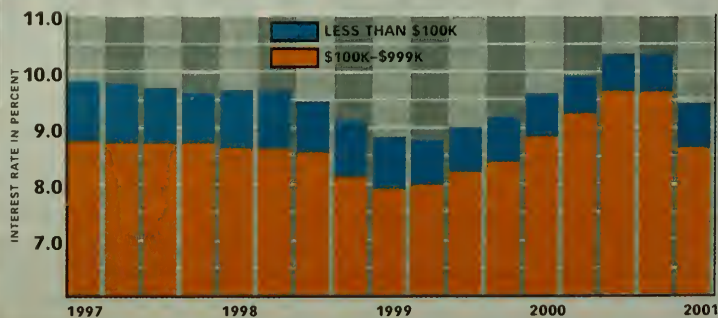
If you can hold off a bit longer, the credit picture could improve by yearend. Competition for small business borrowing remains fierce because it's quite lucrative, and some major lenders are gearing up for better times. Chase Manhattan Bank expects its small-biz lending to rise 30% to 35% this year, and Business Loan Express, a unit of Allied Capital Corp. that makes SBA-guaranteed loans, is hoping for a 20% gain.

But how do you cope without cash in the meantime? Try cutting costs or putting the pet project on the back burner. Or boost your cash flow some other way. The stopgap solution for elevator-company owner Brian Schindler has been to coax customers into paying within 30 days instead of 60 and persuade his own vendors to extend his payment schedules. For now, that's all the lift he's going to get.

@SB For more on borrowing and updated rates, see our Small Biz Finance Guide. Click Online Extras at smallbiz.businessweek.com

Loans: Harder to get but cheaper

Rates haven't been this low since the last quarter of 1999



Data: Federal Reserve

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MONEYraising TIPS

FROM THE **EXPERTS**

LOOKING FOR CAPITAL?

It's true that both banks and equity investors are growing more cautious, but it's still possible to get the cash you need. We asked four small-business experts for advice on raising funds in tougher times.



CHRIS LEHNES

Vice-president for business development at CIT Small Business Lending Corp., Livingston, N.J.

- 1** Put your financials in order. "Be prepared for the bank to ask for even your tax returns."
- 2** Have a clear and specific plan for how you'll use the funds. Avoid speaking in generalities.
- 3** Offer to guarantee the loan personally or provide collateral from your personal assets.



MICHAEL BERNSTEIN

Partner at Grant Thornton, Chicago-based accounting, tax, and management consulting firm

- 1** Explain to your lender how the loan's proceeds will improve your company's profitability.
- 2** Demonstrate that you can control expenses during slow economic times. Show what can be cut.
- 3** Be flexible when negotiating loan terms. "In this environment, they're not in a rush to write you a check."



LISA KIRCHENBAUER

President, Kirchenbauer, Arlington (Va.)-based management and consulting firm

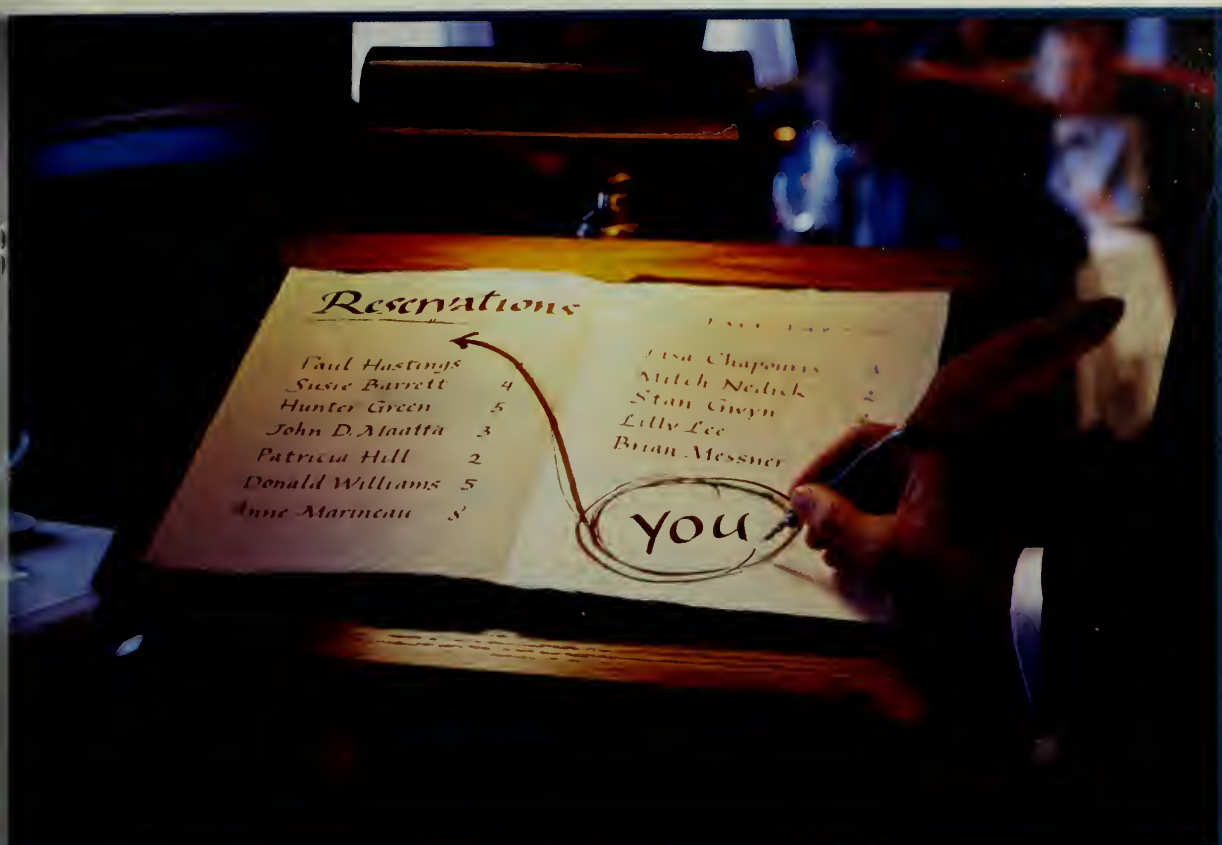
- 1** Defer expenses for six to nine months. "Lenders will loosen up by the end of the year."
- 2** Tap your retirement plan. You could take a loan against your account to raise the needed funds.
- 3** Switch to another bank. A small community bank is often more receptive to local companies.



ROBERT HISRICH

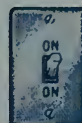
Professor of entrepreneurship at Case Western Reserve University, Cleveland

- 1** Tap your assets. Consider financing inventory, receivables, and equipment.
- 2** Find serious angel investors. They tend to favor a strong company with a good track record.
- 3** Ask a few select friends or family for funds. "Too many people giving small amounts can drive you crazy."



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reality tech>>>

What you need now
(and what you don't)

The flood of small-biz gadgets
has slowed to a trickle.

Thank goodness: Now only
the winners are left, and you
have time to think

BY ALAN HALL • ILLUSTRATIONS BY JOHN HERSEY

A WILD RIDE ON AN EXERCISE BIKE. That's what it's been like for business owners scrambling to keep up with technology. They've pedaled as fast and furiously as they could—and ended up in exactly the same place. Afraid they'd be left in the dust, small companies bought powerful computers, installed advanced software, set up flashy Web sites—and when they were done, figured they needed faster computers, more software, and a still-flashier Web site.

Meanwhile, the cost of staying in the race rose each year at a double-digit clip. "Small businesses' heads have been spinning for five years," says Chris Stephenson, vice-president of iCorps Technologies, a 33-person Internet consulting firm in Boston. "The speed and intensity with which new products, services, and buzz words have been foisted upon us are mind-boggling."

And now? The good news out of the tech sector crackup is that finally you can mop the sweat off your brow and drop

the pace to a jog. For the first time since the Internet became the Web, there's room to breathe. Product cycles are getting longer and "must-have" technology introductions are slowing. The volume of poorly designed goods being rushed prematurely to market has eased, cutting the clutter to a more manageable level.

Call it a tech reality check: It's the perfect chance for savvy companies to examine their strategies and put the squeeze on consultants, vendors, and manufacturers. "I no longer feel that I must keep up or my business will cease to exist," says Larry Namer, chairman of Steeplechase Media, in Santa Monica, Calif., a 16-employee developer of interactive TV and Web content. Last year, Namer regularly read 20 Internet magazines. "Now I'm down to three," he says.

In this dot-calm environment, entrepreneurs who were bedazzled by technology are now casting a flinty eye on results. "People in a downturned economy tend to focus on things that will provide immediate value," says Rick McGee, vice-president of mobile brand marketing at IBM's Personal Computing Division. McGee is pushing wireless local area networks as one technology with an immediate payoff—boosting workers' productivity. But the benefits of

networking didn't move Jeff Rappaport, CEO of 20-employee Outlook Marketing, in Northbrook, Ill. His profits doubled last year, in part because he deferred installing a network. "It could easily cost upwards of \$100,000 for servers, desktops, software, integration, and maintenance alone," says Rappaport.

Things were different in the caffeinated economy. In the mad rush to gain an edge with technology, many businesses bought hardware and software before they really needed it, paid sky-high rates for Web sites that never made them a penny, and overspent on consultants. "There is a great deal of buyer remorse out there as firms look at how much they spent on technology without a return," says William T. Schiano, a professor of electronic commerce at Bentley College in Waltham, Mass.

Were entrepreneurs confused? You bet. Take AntiqueParlor.com, founded in 1999 to market antiques over the Web. When the six-person Newport Beach (Calif.) startup solicited proposals for its first Web site, bids ranged from \$15,000 to \$750,000. "How could an entrepreneur know enough to make an educated decision in a situation like that? It was overwhelming," says founder Scott Buelter.

The alternative: Leave it to a high-priced consultant who could be just as capable of making the wrong decision. Kirk Hoaglund, founder of Clientek, a technology consulting firm in Minneapolis, tells of a client who hired an "Internet project manager" for \$250 per hour. The manager's qualifications? She's a former orchestra conductor. "I admire orchestra conductors, and it is definitely a job that I am woefully unqualified for," says Hoaglund. "Perhaps the reverse is also true."

Technology even cast a shadow of sort that led to more confusion. "People started measuring us not by our cash flow but by the speed of our Internet connection—even our bankers," says Steeplechase Media's Namer.

Now, though, the mantra of "upgrade upgrade, upgrade" is falling on deaf ears. Business owners are scaling back their spending plans for e-marketing, software upgrades, and hardware—both PCs and servers (table, page 36). If a company has bought new computers or Windows 98 in the past few years, there's not much reason to upgrade, says Helen Chan, a small-business analyst at Yankee Group in Boston. "What they've got is still dependable," she says.

The dirty little secret is that much of the innovation in PCs, in particular, consist

Winners to Watch

Tired of tech? Get some rest—then get ready. Before long, you'll probably be using some of these technologies.



Bandwidth Not long ago, only big companies had high-speed Net access—T1 lines costing about \$1,000 a month. Now, small business has affordable cable and DSL, and soon may be able to take advantage of broadband wireless.



Wireless Cell phones and PDAs will merge into a single, multifunctional handheld device that bundles voice and data. Application software is developing rapidly, and broadband wireless modems are on the horizon.



Security As "always-on" broadband connections become common, firewall systems, either hardware or software, are critical to protect your data. Viruses aren't going away, either, making a backup system more important than ever.



Outsourced Applications The entry of branded players, such as Dell, Hewlett-Packard, and Verizon, promises new growth and credibility for an industry that has suffered from hype, skepticism, and a slow start.



Voice Recognition Digital Signal Processing chips keep getting faster. The next step: devices that let you call your computer on your cell phone, dictate an e-mail, and send it.



the new Windows XP. (And with new computers, customers are going to get XP, like it or not.)

This brings up a larger point: Slowing down might make sense, but getting out of the race isn't an option. Smart companies aren't letting fear of buying scuttle their strategic plans. They know that the challenge is to identify which purchases are critical to staying competitive. And there are still plenty of pressing technology issues—"always-on" connections, such as DSL, have made security more important than ever and laptop and wireless technology is advancing rapidly—so you'll need to keep an eye on the future. For now, though, keep in mind the adage about spending in a trough and saving in a swell. This is the time to spend. You can get more bang for the buck right now than ever before. Here's where and how to strike:

f features that few small businesses need, such as complex graphics and sophisticated sound for advanced computer games. So, many are following Chan's advice, despite PC prices that have plunged 10% to 15% in recent months. Indeed, AMI Partners, a New York small-biz market research firm, says small businesses expect to spend about 1% less on PCs this year and about 6% less on networking than in 2000. While they are projected to spend about 9% more on Web sites and e-commerce, the previous year's increase was almost 38%.

Small businesses are also reluctant to upgrade systems. A majority of companies have not moved to Windows 2000, much to Microsoft's chagrin. "The upgrade would have cost only \$25,000, but we felt the change from Windows 98 wasn't sufficient to justify that investment," says one holdout, Patricia Thorp, president of Thorp & Co., a 23-person public relations firm in Coral Gables, Fla.

But Thorp won't be able to hide for long. Microsoft has already discontinued sales and support of Windows 95 and will stop selling Windows 98 to all but major enterprise customers, probably by yearend. At that time, the choice will be basically Windows 2000, or its close cousin,

BUY USED EQUIPMENT There's tons of stuff from the dot-bombs available now at a fraction of the original price—everything from barely used PCs and telephone systems to high-end Sun workstations. On the secondary market, for example, a Cisco Systems network router goes for \$2,500 to \$3,000. New, the same unit costs around \$10,200. Check out Web auctions, liquidators, and refurbishers.

DRIVE A HARD BARGAIN You'd rather have new stuff? Sticker prices haven't changed, but almost everything is negotiable now. It pays to be aggressive and ask for more creative financing options such as longer terms or lower interest rates. Small-business customers are winning discounts as deep as 25% to 60%, says Ken Zolot, chief operating officer of Eggenera Inc., an 85-employee Boston-based Internet infrastructure firm. "With inventories high and vendors strapped for cash, there's no reason to settle for refurbished equipment," he argues.

LEASE IT Don't want the maintenance headache? There are lots of leases out there that can be assumed for a song. In many cases the ability to exit a lease means the difference between bankruptcy and survival. Take a Pitney Bowes Mail Processor leased by a technology company

Tips for small business owners

from the United States Postal Service

Out of business. That's what happened to 528,600 businesses in 1999.* In today's tightening economy, keeping satisfied customers is important. That's why small business owners must make meeting customer demands and requests a priority in managing their day-to-day business. The United States Postal Service® offers the following cost- and time-saving tips for small business owners:

- Take advantage of offers for free shipping supplies from www.usps.com. Keep these supplies on-hand at your business, so you can send packages conveniently on request.
- Returns are a part of life. With post offices everywhere, the U.S. Postal Service offers an easy way for customers to return merchandise.
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For more ideas and services on how the Postal Service can help your business operate more efficiently and cost effectively, visit www.usps.com.

Turn of the Screw

After years of free spending, small businesses are putting the brakes on tech purchases. Here's the projected average for companies with under 100 employees

Technology	2001	Change from '00
Internet	\$3,181	8.7%
Networking	1,681	-6.3
PCs	5,386	-10.9
IT Services	2,130	1.6
Mobile and Wireless	2,451	2.2

Data: AMI-Partners

that went bust. The founder is obligated to pay \$631 per month for the next 19 months even though he can't use the equipment. "He's willing to give value beyond that of the equipment to get out of the lease," says Michael D. Penfield, president and CEO of LeaseTrading, in South Norwalk, Conn. And don't forget real estate. Lots of empty space is up for grabs in those high-tech, wired buildings at bargain-basement prices.

SQUEEZE A CONSULTANT

Remember calling tech consultants a year ago, only to be put on hold or told they weren't interested in "smaller" engagements? Well, the tables have turned; many formerly arrogant consultants are now scrounging for work. "To be quite honest, I am thinking of going in-house—if I can find a job," says one. Those talented techies you couldn't begin to afford last year have lowered salary expectations these days. "We placed an ad last summer for a Web marketing person and received only a handful of résumés. A similar ad placed last month yielded more than 50 inquiries," says Steve Goodman, founder of SPI Group, an online marketing agency with 12 employees in Upper Montclair, N.J.

TRY TO BARTER Larger companies that might have turned their nose up at the practice of bartering may now view it as a way of cutting costs. The longer they hold onto slow-moving capi-

tal equipment, the more it depreciates. So bartering for goods or services may give you both what you need. "We just bartered for a new phone system," says James E. Gray, co-founder of WorkWireless, a 16-person developer of retail point-of-sale computer software in Boston. WorkWireless was installing the POS system at a retail chain, when the owner asked Gray if he'd reduce the installation fees in exchange for a new phone system.

Gray declined to disclose the value of the trade, but swears by the barter system. Keep in mind, however, that unless you and your business partners can set up your own private deal, you'll likely need to work through a barter trade group, such as the International Reciprocal Trade Assn., of Chicago, or Barter Systems, of Kensington, Md. That means you'll have to pay a membership fee and could wind up paying a commission, as well.

BUY CANADIAN The chilly economic climate is even cooler north of the U.S. border. The Canadian dollar, worth 72¢ (U.S.) in 1997, is now worth just 65¢. That means all Canadian goods and services are real deals for those paying with U.S. currency. So if you still want to build that Web site or retool your database, consider outsourcing it to IT outfits in Winnipeg, Toronto, Ottawa, or Montreal. You could save at least one-third of what you'd pay here.

Do these bargains and the slower pace of change mean the tech race is over forever? Not likely: Engineers seem to have an endless ability to turn invention into the mother of necessity, and another group of must-have products is doubtless just over the horizon. Enjoy the breather while it lasts.

@ SB For more information on getting the most out of your technology dollars, click Online Extras at smallbiz.businessweek.com

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AT A GLANCE

WHO: Greg Eisen, 27**COMPANY:** Sportography, Bethel, Conn.**REVENUES:** \$3 million**EMPLOYEES:** 15 full-time, plus about 120 contract photographers**CONCEPT:** Photos of youth athletes on just about anything—from trading cards (9 for \$15) to mouse pads (about \$16 each)

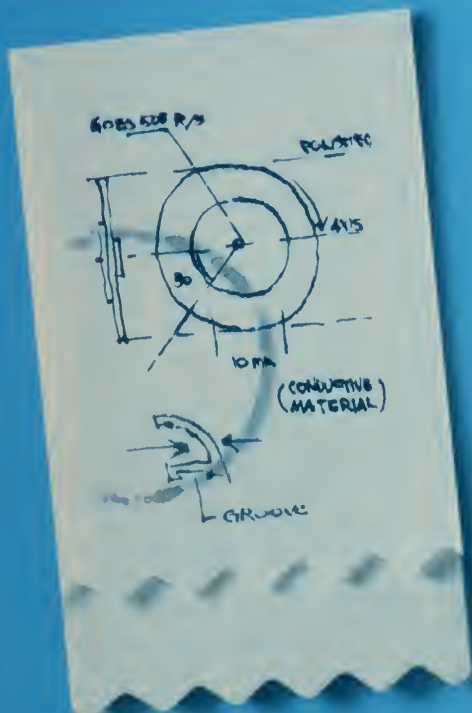
Star Rookie

Most Little Leaguers dream of playing in the pros. Greg Eisen, 27, makes them feel as if they already are. Last year, his Bethel (Conn.) company, Sportography, photographed more than 100,000 kids on 8,400 youth sports teams, splashing their images on trading cards, mock-magazine covers, even mouse pads—just like their big-league heroes. "We provide memories," says Eisen. "That's a tremendous feeling."

Eisen got a job with Sportography in 1989, while still in high school. The company was two years old and had just one employee. But like the kids he photographed, Eisen had big dreams; he wanted to become "the Wal-Mart" of youth sports photography. In 1996, he took his savings, borrowed money from family, and bought a partnership in the business. An energetic salesman, Eisen doubled revenues within a year. Already bigger than nearly all competitors, he aims to expand the company's three branches to seven, including Boston, Cleveland, and Detroit. In 4½ years, he has increased Sportography's revenues tenfold, to about \$3 million—a grand slam by any measure.

—KIMBERLY WEISUL

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COMMENTARY

By Howard Gleckman

SOCIAL SECURITY ISN'T THE ONLY SURPLUS-BUSTER

In early May, President Bush announced a new commission to solve the funding shortfall expected to hit Social Security in coming decades. The topic has obsessed Republicans and Democrats alike for years as the largest long-term budget problem facing America.

Except that it's not. In just 13 years, the federal government will be spending as much on health care—mostly for the elderly—as on Social Security. The problem will get worse after that, when the first big wave of baby boomer retirements hits. It won't be long before providing health care dwarfs the cost of Social Security, according to new studies by three government agencies, the General Accounting Office, the Congressional Budget Office, and the Medicare trustees (chart).

The bulk of the cash will go to Medicare, which targets seniors. The rest will fund Medicaid, a program originally designed to care for poor children that now pays nearly half the nation's nursing-home costs. The bill will jump by tens of billions of dollars a year more if Congress adds a promised prescription drug benefit to Medicare.

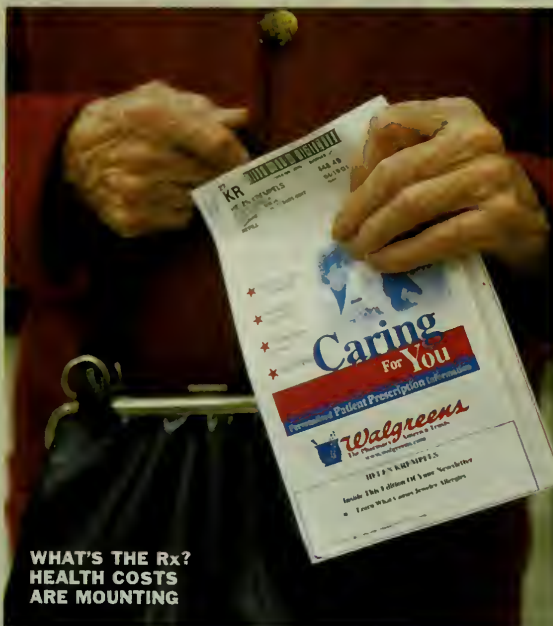
Regrettably, the agencies' staggering conclusions are falling on deaf ears. Instead, Congress and President Bush are talking about a \$1 trillion-plus tax cut, based on visions of massive budget surpluses over the next decade. Yet soaring Medicare and Medicaid expenses are likely to wipe out the entire surplus within the next 15 years or so, according to both the GAO and the CBO.

BIG SQUEEZE. The price of ignoring the problem will be painfully high. Unless ways can be found to rein in costs or limit benefits, lawmakers will have to slash spending on other programs and pass tax hikes much larger than any cuts they agree to this year. "We have a strong probability of being in a mess," argues Jeff Lemieux, a health-care analyst at the

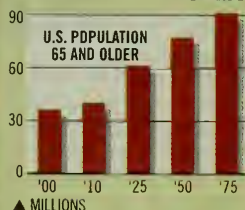
Progressive Policy Institute, a Democratic think tank.

Washington has ignored this unpleasant issue largely because budget projections go out only 10 years, just before big Medicare and Medicaid cost hikes start to kick in. But when they do, the price tag will be enormous. Today, the federal government shells out about \$350 billion, or 3.5% of gross domestic product, on health care. That will double in just two decades. Within 40 years, Washing-

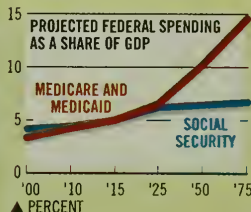
dence. But the actuaries make a plausible argument. The number of Americans over 65 will more than double by 2050 and nearly triple by 2075. At the same time, the amount of money spent per person is skyrocketing. In 1970, Medicare spent about \$350 per beneficiary. In 2000, it spent \$5,655. The cost will hit nearly \$10,000 a person by 2010, according to the Medicare trustees. One primary cause: Advances in medical technology are making care more accessi-



AS THE ELDERLY POPULATION BOOMS...



...SO WILL SPENDING ON HEALTH CARE



Data: Medicare and Social Security trustees, General Accounting Office, Congressional Budget Office

ton will be spending 50% more on health care than on Social Security. By 2075, it will spend more than twice as much—a mind-numbing 14.5% of GDP. That's more than for any other initiative in modern U.S. history, except World War II.

This isn't just some problem for future generations to worry about. Medicaid costs are already squeezing states, which fund 40% of the program. Now, they spend a fifth of their budgets on it. Within a year or two, it could become their single biggest expenditure, higher than K-12 education. The reasons: exploding costs of drugs and nursing homes.

Of course, no one can project decades in advance with much confi-

ble. "When you make procedures cheaper and easier, more and more people use them," says former Medicare trustee Marilyn Moon.

The question, of course, is: Who will pay? The more government spends, the less it has for other priorities. If nothing is done, Medicare and Medicaid "will eat the rest of the budget," warns CBO Director Dan L. Crippen. The new studies offer no clues about how to resolve these conflicts. But they make it clear that Congress must come to grips with funding not just Social Security but also the health care that goes with it.

Gleckman follows government spending from Washington.

Corporate Scoreboard



'THE FIRST QUARTER WAS JUST HORRIBLE'

Except for a few fortunate sectors, this is an earnings season that is best forgotten

For months now, Federal Reserve Chairman Alan Greenspan has been trying to engineer a soft landing for the U.S. economy. But you wouldn't know it from Corporate America's crash-and-burn performance in the first quarter: The earnings

of the 900 companies on *BusinessWeek's* Corporate Scoreboard plummeted 25% from a year earlier, despite a 15% sales gain. Take out the booming fuel sector, and profits fell by fully a third. The first-quarter profit plunge was the Scoreboard's sharpest quar-

terly drop since the 1990-91 recession.

The dismal showing isn't hard to explain: Businesses have been cutting spending for months amid rising labor costs and persistently high energy costs, and now consumers are beginning to follow suit. That penny-pinching has

Winners and Losers in Quarterly Profits

INDUSTRIES

LEADERS

PERCENTAGE CHANGE FROM
2000's FIRST QUARTER

PETROLEUM SERVICES	166%
BEVERAGES	130
COAL, OIL & GAS	86
AEROSPACE & DEFENSE	69
ALUMINUM	60
CONSTRUCTION & REAL ESTATE	48
HEALTH-CARE SERVICES	33
SAVINGS & LOAN	28
BANKS—WEST & SOUTHWEST	28
INSTRUMENTS	26
MISCELLANEOUS SERVICES	25
DRUGS & RESEARCH	17
HOTEL & MOTEL	16
BUSINESS MACHINES & SVCS.	7
SPECIAL MACHINERY	6

LAGGARDS

PERCENTAGE CHANGE FROM
2000's FIRST QUARTER

TELECOMMUNICATIONS	LOSS
BROADCASTING	LOSS
AIRLINES	LOSS
COMPUTER SOFTWARE	LOSS
ELECTRONICS	LOSS
AUTO PARTS & EQUIP.	LOSS
SEMICONDUCTORS	LOSS
INDUSTRIAL DISTRIB.	LOSS
FOREST PRODUCTS	LOSS
STEEL	LOSS
TRANSPORTATION SVCS.	-97%
MISCELLANEOUS LEISURE	-96
BUILDING MATERIALS	-89
CHEMICALS	-86
GLASS CONTAINERS	-82

ALL-INDUSTRY AVERAGE: -25%

COMPANIES

WHO MADE THE MOST

MILLIONS OF
DOLLARS

EXXON MOBIL	\$4,960
CITIGROUP	3,580
GENERAL ELECTRIC	3,017
MICROSOFT**	2,451
PHILIP MORRIS	2,096
WAL-MART STORES***	2,004
PFIZER	1,930
BANK OF AMERICA	1,870
SBC COMMUNICATIONS	1,864
VERIZON COMMUNICATIONS	1,754
IBM	1,750
MERCK	1,657
CHEVRON	1,600
AIG	1,538
JOHNSON & JOHNSON	1,500

WHO LOST THE MOST

MILLIONS OF
DOLLARS

LUCENT TECHNOLOGIES*	-\$3,380
CMGI*	-2,562
AT&T	-1,562
AOL TIME WARNER	-1,369
JOS UNIPHASE**	-1,293
PG&E	-951
SAFECO	-883
I2 TECHNOLOGIES	-774
OOW CHEMICAL	-717
EXDDUS COMMUNICATIONS	-650
WALT DISNEY*	-567
LEVEL 3 COMMUNICATIONS	-535
MOTORDLA	-533
U.S. OFFICE PRODUCTS**	-498
GATEWAY	-479

* FISCAL SECOND QUARTER ** FISCAL THIRD QUARTER *** FISCAL FOURTH QUARTER

Data: Compustat, provided by Standard & Poor's Institutional Market Services



ped wreak havoc on everything from technology companies to airlines to broadcasters. Stellar performances from energy, aerospace, and beverage makers weren't enough to offset falling profits at a litany of other industries. "The first quarter was just horrible," says Kamalesh Rao, an economist at Moody's Investors Service.

WRITE-OFF. And the pain may not be over yet. The second quarter is expected to be as bad as or worse than the first, and many economists are predicting that third-quarter earnings will be down, too. Still, analysts expect companies in the Standard & Poor's 500-stock index to see an average 2.9% drop in earnings this year, vs. 16.2% growth in 2000, according to earnings tracking firm First Call Corp. "We're expecting negative numbers through the first three quarters," echoes Wells Fargo & Co. chief economist Sung Won Sohn, who is predicting a 7% earnings drop for 2001. "We might as well write off this year."

A glance at some major economic indicators suggests that earnings should have been so bad. For instance, first-quarter growth in gross domestic product was healthier than anticipated at 2%, double the 1% growth in the first three months of 2000. But that represents a dramatic slowdown. After increasing 5.3% during the year ended March, 2000, real GDP growth slowed to 2.7% in the following year. Similarly, the 3.1% rise in first-quarter consumer spending seems solid. But analysts say it came at the expense of profitability, as many companies resorted to heavy discounting, particularly in the auto industry, and deep price cuts to move goods.

Likewise, the strong performance at the big corporate earners crumbles with a closer look at the numbers. Kaiser Aluminum Corp. racked up one of the biggest percentage increases in first-quarter profits, with a rise of 922%, \$119.6 million. But strip out a one-

time gain from the resale of power, and the company actually lost \$9.1 million.

More impressive was the 626% profit gain logged at Juniper Networks Inc., whose Internet routers compete head-on with those of giant Cisco Systems Inc. Even as the tech industry slowed, Juniper continued to gain market share during the quarter, which helped lift profits to \$58.6 million. Meanwhile, Cisco's profits rose 7%, to \$874 million.

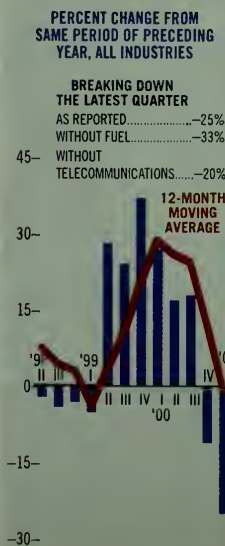
Exxon Mobil Corp. once again takes the crown as overall earnings champ, raking in \$4.96 billion in the first quarter, up 64% over a year ago. Fueled by high crude-oil and natural-gas prices, the earnings were the second-largest ever for ExxonMobil, topped only by the \$5.12 billion profit posted in the

fourth quarter, the U.S. record. Rising energy prices also helped lift revenues for utilities by 119%, though a \$1 billion quarterly loss by PG&E Corp. led to a 1% earnings decline for the sector.

Citigroup Inc. reported the next-highest profit for the first quarter, \$3.58 billion, but that was still 7% lower than its earnings a year earlier. Strong growth in the consumer division wasn't enough to offset slowing private-client revenues and losses in its corporate loan portfolio. Third place went to General Electric Co., which earned \$3.02 billion, a 16% gain from a year ago. Although profits fell in GE's more cyclical businesses, that was more than offset by double-digit gains in financial services and such long-

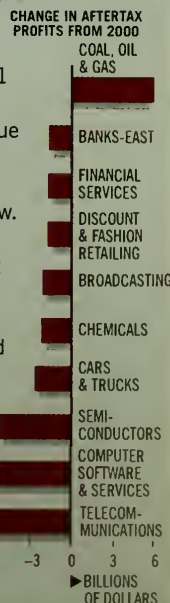
A Spotlight on First-Quarter Profits

AFTERTAX PROFITS QUARTER BY QUARTER



INDUSTRIES WITH THE BIGGEST DOLLAR CHANGE IN THE QUARTER

Yech! What a difference a year makes. In the first quarter of 2000, earnings jumped 27%. But it's 2001 now. Profits were down 25% in the first quarter on a 15% gain in revenue (8% if the 119% sales jump of the utilities is taken out), the second double-digit drop in earnings in a row. Few industries escaped. Telecom? AT&T lost \$1.6 billion, while Lucent lost \$3.4 billion. Software? Look at CMGI's \$2.6 billion loss. Semiconductors? Intel's earnings dropped 82%. Autos? Try GM's 87% profit plunge. At least we have the spectacular results of the oil companies to remind us of quarters past. Exxon Mobil and Texaco earnings were up 45%, Chevron was up 53%.



Data: Compustat, provided by Standard & Poor's Institutional Market Services

Corporate Scoreboard

cycle businesses as power turbines and medical equipment.

The aerospace and defense sector was also a bright spot, with Boeing, Lockheed Martin, General Dynamics, and United Technologies all delivering solid performances. At Boeing Co., for example, income rose 196%, to \$1.24 billion. That was driven by 122 commercial aircraft deliveries, vs. 75 in the same period a year ago. The reason: an engineers' strike during the first quarter of 2000, which slowed deliveries.

BAD VISIBILITY. The first-quarter picture wasn't so pretty for many of Boeing's customers. Airlines did terribly during the quarter: All but two of the major carriers—Southwest Airlines Co. and Continental Airlines Inc.—lost money. Hardest hit was UAL Corp., which racked up a \$304 million deficit during the quarter, vs. a \$111 million profit a year ago. A big factor was the 27% jump in fuel prices over the past year. "That is something we did not predict," says UAL President Rono J. Dutta. "The cost side has taken us by surprise."



The auto industry fared even worse, as layoffs and stock-market losses continued to gnaw at consumer confidence. At No. 1 auto maker General Motors Corp., earnings tanked 87%, to \$225 million, as sales dropped 9% and pressure to keep prices down increased in the key North American and European markets. Ditto at Ford Motor Co., the world's second-largest auto maker, where earnings sank 45%.

The carnage was worst in the telecom and tech sectors. A collapse in prices for long-distance service caused a \$1.56

billion loss at AT&T. In the year-ago period, the telecom giant posted \$1.74 billion in net income. And as companies put the brakes on capital spending (see chart), telecom-equipment maker Lucent Technologies Inc. lost \$3.38 billion for the quarter. The slowdown in tech spending also hit Motorola Inc., which posted its first quarterly operating loss in 16 years and Intel Corp., which racked up an 82% decline in first-quarter net income to \$485 million. Profit at Compaq Computer Corp. dropped 76%, to \$78 million as PC and server sales stalled. The first quarter, says Chairman and CEO Michael D. Capellas, was an "extremely rocky start" to the year.

And it could get rockier. First-quarter earnings disappointments are up 49% over a similar point during the first quarter of 1999. "That's a pretty ominous sign," says search director Charles L. Hill. In other words, there's no soft landing in sight for this earnings recession.

By Stephanie Anderson Forest Dallas, with bureau reports

THE CORPORATE FORECAST: SERIOUS SCRIMPING

Capital investment helps drive earnings, but with executives still hitting the brakes on spending, don't expect profits to take off any time soon. Capital spending fell in the past two quarters, and the Federal Reserve's aggressive interest-rate cuts won't reverse that trend before next year, economists say.

"It was the investment boom that made the late 1990s a special period for the economy and corporate earnings, and the investment bust suggests the next year is going to be very tough for the economy and earnings," says Mark M. Zandi, chief economist at Economy.com Inc.

Business spending on capital equipment grew on average by 15% a year from 1997 to mid-2000, then it contracted in last year's fourth quarter (chart). That's hurting companies in two ways: It cuts profits at outfits supplying capital equipment and retards earnings at companies that forgo the productivity gains resulting from capital investment. Spending on info-tech equipment and software has seen the sharpest drop—it fell 6.4% in the first quarter from the previous quarter. That's slamming tech suppliers, such as Lucent, Texas Instru-

ments, and JDS Uniphase. Verizon Communications, for one, will cut its planned capital spending for this year by \$1 billion, to \$17.5 billion. "We feel that this is a prudent action to take right now, to tap on the brakes in terms of capital," says Chief Financial Officer Fred Salerno.

DOWNDRAFT. The same belt-tightening is happening elsewhere in Corporate America. The Commerce Dept. says orders for nondefense capital goods, excluding the volatile aircraft category, fell about 2% in March, vs. February. And a survey of purchasing executives at non-manufacturing industries by the National Association of Purchasing Management showed that business activity and new orders fell in April, the first contraction registered by the monthly survey since it began in 1997.

Don't count on sharply lower interest rates to boost investment, at least in the short term. Executives

respond first to business demand and the need to expand capacity. "Interest rates are last in terms of importance," says Jan Hatzius, senior economist at Goldman, Sachs & Co. With demand slowing—especially as rising unemployment saps consumer confidence—there's plenty of unused

equipment in most industries, so cheaper money to buy equipment misses the point. "Investment will stay negative through this year and show a slight rebound in 2002," predicts Hatzius.

Investment eventually will pick up. But real capital spending at a level seen in the late 1990s won't soon

be repeated. "That was a speculative bubble, juiced up by extraordinary expectations in the stock market," says Zandi. Given the current earnings doldrums, though, even a modest gain would be welcome.

By Charles J. Whalen, with Peter Elstrom in New York



First Quarter 2001

CORPORATE SCOREBOARD

Glossary

SALES: Includes all sales and other operating revenues. For banks, includes all operating revenues.

EBITDA: Net income before extraordinary items. For banks, EBITDA is net income after security gains or losses.

EBIT: Net income from continuing operations before extraordinary items as percent sales.

RETURN ON INVESTED CAPITAL:

Ratio of net income before extraordinary items and discontinued operations, plus minority interest and interest expenses (except for banks), adjusted by tax rate (all for most recent 12 months) to latest available total funds invested in company.

RETURN ON COMMON EQUITY:

Ratio of net income available for common stockholders (most recent 12 months) to latest available common equity,

which includes common stock, capital surplus, and retained earnings.

PRICE-EARNINGS RATIO: Based on May 3, 2001, common-stock price and corporate earnings from continuing operations before extraordinary items for most recent 12-month period.

GROWTH IN COMMON EQUITY:

Average annual percentage growth in historical common equity for latest five-year period.

GROWTH IN EARNINGS PER SHARE:

Average annual percentage growth in basic historical earnings per share, including common-stock equivalents, for the latest five-year period.

MARKET VALUE: Latest available shares outstanding times stock price on May 3, 2001.

EARNINGS PER SHARE: For most recent 12-month period. For most companies, this figure represents diluted earnings per share.

COMPANY SYMBOL	SALES		PROFITS		MARGINS		RETURN		5-YEAR GROWTH			MARKET VALUE SHARES OUTSTANDING \$ MIL.	12 MONTHS' EARNINGS PER SHARE
	1ST QUARTER 2001 \$ MIL.	CHANGE FROM 2000 %	1ST QUARTER 2001 \$ MIL.	CHANGE FROM 2000 %	1ST QUARTER 2001 %	1ST QUARTER 2000 %	ON INVESTED CAPITAL %	ON COMMON EQUITY %	P-E 5-3	COMMON EQUITY %	EARNINGS PER SHARE %		
ALL-INDUSTRY COMPOSITE	2036169.9	15	91761.7	-25	4.5	7.0	9.1	12.7	28	16	12	11436959	1.43
AEROSPACE & DEFENSE													
INDUSTRY COMPOSITE	37238.2	10	2415.0	69	6.5	4.2	10.0	14.4	21	11	14	149532	2.73
BOEING BA	13293.0	34	1236.0	196	9.3	4.2	16.4	24.1	19	2	28	53440	3.43
GENERAL DYNAMICS GD	2673.0	5	240.0	30	9.0	7.2	25.1	25.1	17	20	20	15771	4.76
LOCKHEED (B.F.) GR	1177.3	10	80.9	11	6.9	6.8	13.0	22.9	14	7	3	4338	2.79
RAYSON INDUSTRIES LIT (5)	1344.9	0	49.7	35	3.7	2.7	9.4	13.4	16	14	7	3629	4.90
LOCKHEED MARTIN LMT	5010.0	-10	105.0	94	2.1	1.0	-2.2	-5.1	NM	5	NA	15507	-0.94
PORT NEWS SHIPBUILDING NNS	485.0	3	24.0	14	4.9	4.5	12.4	35.9	22	6	NA	1913	2.90
ORTHROP GRUMMAN NOC	1986.0	10	103.0	-34	5.2	8.7	11.8	14.3	11	20	10	6601	8.01
PRECISION CASTPARTS PCP (9)	630.0	14	39.4	46	6.3	4.9	9.9	14.4	16	26	22	2051	2.45
RAYTHEON RTN.8	3968.0	-6	97.0	21	2.4	1.9	4.6	4.8	19	23	-17	9452	1.50
UNITED TECHNOLOGIES UTX	6671.0**	4	440.0	17	6.6	5.9	18.4	23.8	21	15	16	36830	3.68
AUTOMOTIVE													
INDUSTRY COMPOSITE	120063.0	-7	905.1	-82	0.8	4.0	8.2	11.6	14	-3	6	121045	2.09
(A) CARS & TRUCKS													
GROUP COMPOSITE	88353.2	-7	1304.6	-67	1.5	4.2	9.0	14.8	12	-10	8	89853	2.98
CHRYSLER F	42361.0	-1	1059.0	-45	2.5	4.5	9.4	24.3	11	-4	17	53210	2.57
GENERAL MOTORS GM	42623.0**	-9	225.0	-87	0.5	3.8	8.8	9.4	13	2	-3	30742	4.38
AVISTAR INTERNATIONAL NAV (2)	1499.0	-30	-35.0	NM	NM	3.2	5.0	4.2	30	17	38	1604	0.90
SHKOSH TRUCK OTRK8 (3)	342.0	3	11.3	-5	3.3	3.6	12.1	15.5	13	15	32	630	2.92
ACCAR PCAR	1528.2	-34	44.3	-71	2.9	6.6	NA	15.1	11	13	19	3667	4.32
(B) PARTS & EQUIPMENT													
GROUP COMPOSITE	31709.9	-10	-399.5	NM	NM	3.4	4.3	4.6	28	16	1	31192	0.68
AMERICAN AXLE & MFG. HOLDINGS AXL	761.1	-9	24.0	-40	3.2	4.8	12.8	28.7	6	32	57	564	2.30
RVINMERITOR ARM (3)	1787.0	49	21.0	-63	1.2	4.8	6.8	10.5	11	69	26	998	1.38
UTOLIV ALV	1080.6	0	20.8	-62	1.9	5.1	7.0	7.1	14	43	-1	1875	1.34
ORGWARNER BWA	606.8	-17	21.1	-49	3.5	5.6	6.3	6.7	16	14	11	1154	2.82
DOOPER TIRE & RUBBER CTB	757.6	-18	3.6	-88	0.5	3.4	6.3	7.4	13	6	3	857	0.94
ANA DCN	2753.0**	-25	-27.0	NM	NM	6.6	NM	2.5	44	21	-4	3012	0.46
ELPHI AUTOMOTIVE SYSTEMS DPH	6535.0	-16	-429.0	NM	NM	3.7	9.1	10.6	24	NA	NA	8051	0.60
URA AUTOMOTIVE SYSTEMS DRRA	661.9	-3	9.2	-44	1.4	2.4	6.3	7.8	6	75	9	208	1.96
ATON ETN	1983.0	-9	50.0	-56	2.5	5.2	7.7	11.6	17	5	5	4993	4.20
FEDERAL-MOGUL FMO	1450.7	-12	-62.2	NM	NM	0.8	NA	-27.0	NM	52	NA	222	-5.16
ENCORP GY (1)	353.0	48	17.0	70	4.8	4.2	12.6	29.2	8	33	-1	504	1.46
DOODYEAR TIRE & RUBBER GT	3414.2	-7	-46.7	NM	NM	1.3	NM	-1.6	NM	2	-27	3873	0.35

(1) First quarter ended Feb. 28. (2) First quarter ended Jan. 31. (3) Second quarter ended Mar. 31. (4) Second quarter ended Feb. 28. (5) Second quarter ended Jan. 31. (6) Third quarter ended Mar. 31. (7) Third quarter ended Feb. 28. (8) Third quarter ended Jan. 31. (9) Fourth quarter ended Mar. 31. (10) Fourth quarter ended Feb. 28. (11) Fourth quarter ended Jan. 31. *Sales include excise taxes. **Sales include other income. ***Sales include excise taxes and other income. †Revenues from some major subsidiaries are not included in consolidated sales; parent's share of earnings is included in profits. NA = not available. NM = not meaningful. Earnings per share are for latest 12 months, not necessarily for end of most recent fiscal year; they include all common-stock equivalents but exclude extraordinary items.

Data: Compustat, provided by Standard & Poor's Institutional Market Services

CORPORATE SCOREBOARD

COMPANY SYMBOL	SALES		PROFITS		RETURN				5-YEAR GROWTH				MARKET VALUE SHARES OUTSTANDING \$ MIL.	12 MONTH EARNINGS PER SHARE
	1ST QUARTER 2001 \$ MIL.	CHANGE FROM 2000 %	1ST QUARTER 2001 \$ MIL.	CHANGE FROM 2000 %	MARGINS		ON INVESTED CAPITAL %	ON COMMON EQUITY %	P-E 5-3	COMMON EQUITY %	EARNINGS PER SHARE %			
					1ST QUARTER 2001 %	1ST QUARTER 2000 %								
HAYES LEMMERZ INTERNATIONAL HAZ ⁽¹¹⁾	475.4	-16	-16.5	NM	NM	2.8	NM	-24.1	NM	-2	22	203	-1.4	
LEAR LEA	3503.6	-8	15.1	-76	0.4	1.6	10.1	14.6	10	20	16	2313	3.4	
TENNECO AUTOMOTIVE TEN	864.0	-2	-31.0	NM	NM	0.1	NM	-29.6	NM	NA	NA	109	-2.0	
VISTEON VC	4723.0	-10	31.0	-79	0.7	2.8	5.8	4.4	14	NA	NA	2256	1.1	
3 BANKS														
INDUSTRY COMPOSITE	90520.3	2	10602.9	-18	11.7	14.6	3.2	13.1	21	21	10	715915	2.0	
(A) BANKS - EAST														
GROUP COMPOSITE	28657.1	-3	2617.5	-38	9.1	14.4	NM	15.0	19	14	16	240851	2.5	
BANK OF NEW YORK BK	1891.0**	7	384.0	14	20.3	19.1	NA	24.4	26	3	14	37485	1.9	
BANKNORTH GROUP BKNG	385.3	3	55.4	11	14.4	13.3	NA	14.5	14	35	6	2746	1.3	
FLEETBOSTON FINANCIAL FBF	5442.0	-22	142.0	-87	2.6	15.5	NA	13.4	14	24	26	36262	2.8	
J.P. MORGAN CHASE JPM	15015.0**	1	1224.0	-38	8.2	13.4	5.5	12.9	20	15	14	97226	2.4	
M&T BANK MTB	660.3	40	83.7	23	12.7	14.5	5.3	11.2	21	28	14	6960	3.4	
MELLON FINANCIAL MEL	1544.0**	3	264.0	4	17.1	16.9	NA	26.3	21	4	13	20381	2.0	
NORTH FORK BANCORPORATION NFB	305.5**	19	78.4	NM	25.7	0.7	NA	25.6	14	26	19	4285	1.8	
PNC FINANCIAL SERVICES GROUP PNC	1873.0	-1	265.0	-12	14.1	16.0	NA	17.0	16	3	24	18438	3.9	
STATE STREET STT	1541.0**	8	121.0	-19	7.9	10.5	16.7	16.2	30	15	22	17068	3.4	
(B) BANKS - MIDWEST														
GROUP COMPOSITE	26702.5	7	3388.7	-10	12.7	15.1	NM	12.1	28	25	10	229814	1.3	
BANK ONE ONE	6528.0	-1	679.0	-1	10.4	10.5	NM	-2.8	NM	24	NA	44911	-0.4	
COMERICA CMA	1163.7**	4	93.6	-52	8.0	17.5	NA	14.7	13	9	16	9149	4.0	
FIFTH THIRD BANCORP FITB	1110.1	10	244.3	18	22.0	20.5	16.3	18.4	28	24	16	25309	1.9	
HUNTINGTON BANCSHARES HBAN	635.7	-1	67.9	-35	10.7	16.2	NA	12.1	13	10	5	3745	1.1	
KEYCORP KEY	2025.0**	3	218.0	-41	10.8	18.7	NA	12.7	12	7	9	9965	1.9	
NATIONAL CITY NCC	2346.5	9	335.4	4	14.3	14.9	NA	19.6	13	18	8	16461	2.1	
NORTHERN TRUST NTRS	882.9**	11	127.2	12	14.4	14.2	NA	20.1	31	13	18	14621	2.1	
TCF FINANCIAL TCB	295.8**	10	48.2	18	16.3	15.1	NA	21.6	16	11	21	3097	2.4	
U.S. BANCORP USB	4419.7	10	410.1	-40	9.3	17.1	12.3	21.2	NA	66	18	21011	NA	
WELLS FARGO WFC	7295.0	14	1165.0	12	16.0	16.2	NA	15.6	20	46	10	81545	2.3	
(C) BANKS - SOUTH & SOUTHEAST														
GROUP COMPOSITE	31398.5	0	4093.5	-11	13.0	14.8	4.5	12.1	17	24	6	215562	2.3	
AMSCORP BANCORPORATION ASO	882.1	-12	126.2	-9	14.3	13.9	NA	11.0	20	18	-1	6435	0.8	
BANK OF AMERICA BAC	14021.0	-1	1870.0	-17	13.3	15.9	NA	14.6	13	37	4	89631	4.3	
BB&T BBT	1476.0	15	218.4	15	14.8	14.8	NA	14.2	22	23	14	14625	1.6	
FIRST TENNESSEE NATIONAL FTN	627.0**	16	62.4	58	9.9	7.3	13.2	18.4	17	10	9	4232	1.9	
FIRST UNION FTU	5571.0**	-9	610.0	-27	11.0	13.6	NA	-0.6	NM	14	-34	29183	-0.1	
HIBERNIA HIB	383.1	12	50.3	0	13.1	14.6	6.4	11.4	15	15	2	2480	1.0	
NATIONAL COMMERCE BANCORPORATION NCBC	391.4	13	72.2	21	18.5	17.2	NA	10.2	40	30	8	5162	0.6	
POPULAR BPOP	665.4	7	73.5	15	11.1	10.3	8.3	14.6	15	12	13	4132	2.0	
REGIONS FINANCIAL RGBK	956.0	1	122.8	-16	12.8	15.4	6.8	14.6	13	26	5	6683	2.2	
SOUTHTRUST SOTR	974.9	5	129.9	10	13.3	12.7	NA	14.0	16	19	13	7880	2.9	
SUNTRUST BANKS STI	2269.8	11	337.5	6	14.9	15.6	8.1	15.9	15	16	11	19195	4.4	
SYNOVUS FINANCIAL SNV	516.6	15	71.9	17	13.9	13.6	13.0	18.2	30	16	15	8371	0.9	
UNION PLANTERS UPC	813.3	12	106.4	5	13.1	13.9	11.2	13.5	13	29	3	5276	3.0	
WACHOVIA WB	1850.9	8	242.1	-1	13.1	14.3	NA	13.2	15	11	6	12277	4.0	
(D) BANKS - WEST & SOUTHWEST														
GROUP COMPOSITE	3762.2	17	503.2	28	13.4	12.2	14.7	15.3	18	18	8	29688	2.2	
BANCWEST BWE	437.4	24	61.7	25	14.1	14.1	7.4	11.2	14	30	5	3081	1.8	
PACIFIC CENTURY FINANCIAL BOH	410.9	28	33.7	-15	8.2	12.4	6.1	7.8	17	4	-1	1818	1.3	
PROVIDIAN FINANCIAL PVN	1605.8	18	228.6	31	14.2	12.9	NA	32.0	22	52	54	15064	2.4	
UNIONBANCAL UB	789.5	5	107.3	-32	13.6	21.1	10.3	11.7	12	NA	13	4757	2.4	
ZIONS BANCORPORATION ZION	518.7	18	71.9	NM	13.9	NM	10.0	12.4	18	39	7	4968	2.9	
4 CHEMICALS														
INDUSTRY COMPOSITE	29813.6	-1	338.5	-86	1.1	8.3	7.1	9.5	26	9	-13	127617	1.3	
AIR PRODUCTS & CHEMICALS APD ⁽³⁾	1498.3	11	94.6	99	6.3	3.5	6.8	8.8	37	4	-12	9115	1.1	
CABOT CBT ⁽³⁾	458.0	15	28.0	0	6.1	7.1	8.3	10.0	24	6	-8	2230	1.4	
CROMPTON CK	737.9	-4	15.8	-47	2.1	3.9	7.1	10.1	15	28	1	1124	0.6	
CYTEC INDUSTRIES CYT	376.1	2	17.2	-46	4.6	8.7	19.1	26.3	8	14	17	1305	3.8	
DOW CHEMICAL DOW	7386.0**	2	-717.0	NM	NM	7.0	4.1	3.6	42	3	-4	23984	0.8	
DUPONT DD	6859.0**	-10	484.0	-40	7.1	10.6	11.8	15.2	24	9	-25	47071	1.8	
EASTMAN CHEMICAL EMN	1344.0**	10	37.0	-46	2.8	5.6	8.6	15.0	15	3	-23	4040	3.5	
FERRO FOE	370.7	3	14.0	-24	3.8	5.1	13.0	27.4	12	-8	14	717	1.8	
FULLER (H.B.) FULL ⁽¹⁾	306.9	-5	5.6	-43	1.8	3.0	9.3	11.1	13	5	4	599	3.1	
GEORGIA GULF GGC	368.9	-12	-6.6	NM	NM	7.5	7.8	24.5	22	24	-15	572	0.8	
GRACE (W.R.) GRA	395.7	3	14.6	-40	3.7	6.3	NA	NM	NM	NA	NA	128	-1.4	
GREAT LAKES CHEMICAL GLK	410.3	1	20.2	-29	4.9	7.0	9.3	12.5	14	-9	-13	1605	2.3	
IMC GLOBAL IGL	520.1	-13	11.1	-72	2.1	6.6	2.7	7.5	24	-2	-22	1346	0.4	
INTERNATIONAL FLAVORS & FRAGRANCES IFF	483.7	31	20.3	-54	4.2	11.8	11.2	18.2	24	-10	-9	2387	1.0	

CORPORATE SCOREBOARD

COMPANY SYMBOL	SALES		PROFITS		RETURN				5-YEAR GROWTH			MARKET VALUE SHARES OUTSTANDING 5-3 \$ MIL.	12 MONTHS' EARNINGS PER SHARE
	1ST QUARTER 2001 \$ MIL.	CHANGE FROM 2000 %	1ST QUARTER 2001 \$ MIL.	CHANGE FROM 2000 %	MARGINS		ON INVESTED CAPITAL %	ON COMMON EQUITY %	P-E 5-3	COMMON EQUITY %	EARNINGS PER SHARE %		
					1ST QUARTER 2001 %	1ST QUARTER 2000 %							
BRIZOL LZ	454.6	2	18.5	-39	4.1	6.8	10.2	14.2	15	-2	-5	1518	2.03
ONDELL CHEMICAL LYO	857.0	-25	-34.0	NM	NM	27.9	NM	11.6	15	26	-5	1826	1.01
LENNIUM CHEMICALS MCH	444.0	5	-15.0	NM	NM	5.9	7.9	8.9	13	-7	-11	1089	1.27
INSANTO MON	1306.0	-1	55.0	28	4.2	3.3	4.1	3.2	45	NA	NA	8417	0.72
LYONE POL	709.7	105	-21.4	NM	NM	4.0	NM	-2.4	NM	26	5	788	-0.27
AXAIR PX	1335.0	9	126.0	11	9.4	9.3	10.2	16.0	21	13	7	7596	2.32
HM & HAAS ROH	1688.0**	-4	64.0	-48	3.8	7.0	5.3	8.1	26	19	-1	7599	1.34
DTTS SMG ⁽³⁾	756.6**	8	84.8	33	11.2	9.0	9.0	14.0	17	17	24	1192	2.49
LUTIA SOI	747.0	-12	22.0	-57	2.9	6.0	NM	NM	63	NA	-32	1369	0.21
CONGLOMERATES													
DUSTRY COMPOSITE	47838.7	0	3337.0	-8	7.0	7.6	9.4	21.1	35	11	12	543980	1.32
EGHENY TECHNOLOGIES ATI	542.5	-13	6.4	-85	1.2	6.6	7.1	9.5	15	19	-15	1438	1.21
IXTER INTERNATIONAL AXE	880.3	16	20.9	30	2.4	2.1	8.8	15.7	13	3	27	1008	2.12
NERAL ELECTRIC GE	30434.0**	2	3017.0	16	9.9	8.6	9.7	25.8	37	11	14	481754	1.31
NEYWELL INTERNATIONAL HON	5944.0	-2	41.0	-92	0.7	8.4	10.4	12.3	33	23	5	39073	1.47
IN OFFICE SOLUTIONS IKN ⁽³⁾	1361.2	0	16.7	-52	1.2	2.6	6.0	5.6	14	-2	-39	1104	0.55
LL PLL ⁽⁵⁾	304.7	3	29.9	-12	9.8	11.5	15.5	18.9	20	2	-6	2834	1.16
PSIAMERICAS PAS	705.4	29	12.8	25	1.8	1.9	4.5	5.1	27	17	-18	2210	0.52
KTRON TXT	3040.0**	-8	113.0	-28	3.7	4.8	5.2	5.8	33	5	-2	7663	1.63
W TRW	4167.0	-9	55.0	-74	1.3	4.6	8.3	12.2	17	5	11	4729	2.27
VO VVI	459.6	13	24.3	-7	5.3	6.4	14.6	19.2	16	10	303	2167	1.58
CONSUMER PRODUCTS													
DUSTRY COMPOSITE	83994.4	6	6754.4	16	8.0	7.3	17.1	29.7	23	7	8	614948	1.92
APPAREL													
GROUP COMPOSITE	7582.0	4	367.5	-4	4.8	5.3	13.8	16.0	17	7	8	26049	2.22
OWN SHOE BWS ⁽¹¹⁾	407.6**	14	5.0	28	1.2	1.1	11.5	13.5	9	3	89	328	2.04
YES APPAREL GROUP JNY	1070.0	-1	96.0	35	9.0	6.6	19.0	21.1	16	39	32	5197	2.65
LLWOOD KWO ⁽¹¹⁾	540.3	17	-1.6	NM	NM	1.2	9.6	14.1	8	7	-1	477	2.57
CLAIBORNE LIZ	826.7	2	45.5	-2	5.5	5.7	17.4	22.0	14	-3	14	2516	3.47
KE NKE ⁽⁷⁾	2170.1	0	97.4	-33	4.5	6.7	15.2	16.0	20	10	3	11042	2.02
ILLIPS-VAN HEUSEN PVH ⁽¹¹⁾	374.0	26	6.6	149	1.8	0.9	8.5	11.2	15	-2	96	443	1.10
EBOOK INTERNATIONAL RBK	769.9	0	41.2	30	5.4	4.1	12.2	14.1	17	-3	-26	1524	1.52
WFC	1423.3	5	77.5	0	5.4	5.7	10.2	11.9	18	4	13	4522	2.27
APPLIANCES & HOME FURNISHINGS													
GROUP COMPOSITE	18439.9	8	667.0	-24	3.6	5.1	14.9	18.0	21	4	26	46514	1.38
O BATH & BEYONO BBY ⁽¹⁰⁾	746.1	31	64.3	33	8.6	8.5	21.0	21.0	46	39	34	7795	0.59
ST BUY BBY ⁽¹⁰⁾	5461.6	27	189.7	16	3.5	3.8	22.5	24.3	30	26	59	11743	1.86
RCUIT CITY GROUP CC ⁽¹⁰⁾	3177.1	-9	101.2	-37	3.2	4.6	6.7	6.6	21	NA	5	3083	0.73
RNITURE BRANDS INTERNATIONAL FBN	506.2	-10	19.7	-36	3.9	5.4	10.6	16.0	12	12	30	1181	1.93
ARMAN INTERNATIONAL INOUSTRIES HAR ⁽⁶⁾	435.7	3	-18.4	NM	NM	5.3	6.4	8.9	32	9	-6	1069	1.04
MBALL INTERNATIONAL KBALB ⁽⁶⁾	312.7	1	6.9	-40	2.2	3.7	9.1	9.0	13	5	6	581	1.11
-Z-BOY LZB ⁽⁸⁾	531.4	41	16.1	-24	3.0	5.7	9.8	13.0	12	13	19	1080	1.45
GGETT & PLATT LEG	1053.3	1	46.0	-38	4.4	7.1	9.8	13.1	17	20	13	3912	1.18
KENS 'N THINGS LIN	379.2	16	4.7	-7	1.2	1.5	13.3	13.7	17	35	43	1102	1.57
YTAG MYG	1076.5	-2	76.3	0	7.1	6.9	37.6	307.9	14	-40	22	2599	2.50
ER 1 IMPORTS PIR ⁽¹⁰⁾	430.5**	13	36.5	7	8.5	9.0	17.4	17.8	12	16	39	1149	0.97
DIOSHACK RSH	1139.5	9	46.5	-33	4.1	6.7	30.0	41.3	18	-13	19	5705	1.72
HIRLPOOL WHR	2517.0	-3	33.0	-71	1.3	4.3	14.6	18.2	14	-1	18	3737	4.17
ILLIAMS-SONOMA WSM ⁽¹¹⁾	673.2	19	44.5	-8	6.6	8.6	14.8	13.3	28	29	70	1778	1.13
BEVERAGES													
GROUP COMPOSITE	18580.6	5	1800.4	130	9.7	4.4	15.3	27.9	31	8	3	237223	1.40
IHEUSER-BUSCH BUD	2980.6	6	394.4	13	13.2	12.5	16.8	38.6	23	-1	13	36551	1.74
OWN-FORMAN BF.B ⁽⁸⁾	495.3	0	56.3	3	11.4	11.1	19.5	20.3	18	14	8	4191	3.37
ICA-COLA KO	4479.0	5	873.0	NM	19.5	NM	32.4	33.4	37	13	-7	116163	1.25
ICA-COLA ENTERPRISES CCE	3352.0	2	-84.0	NM	NM	NM	4.2	6.6	41	18	7	7362	0.43
INSTELLATION BRANOS STZ ⁽¹⁰⁾	544.0	2	18.4	18	3.4	2.9	7.9	15.8	13	17	26	1240	5.21
IORS (AODLP) RKY	543.7	8	18.3	24	3.4	2.9	10.0	12.1	17	6	22	1958	3.02
PSI BOTTLING GROUP PBG	1647.0	7	26.0	53	1.6	1.1	6.4	15.0	25	NA	NA	5787	1.59
PSICO PEP	4539.0	8	498.0	18	11.0	10.1	22.0	29.9	29	0	13	63971	1.53
PERSONAL CARE													
GROUP COMPOSITE	18320.8	-2	1579.5	4	8.6	8.2	19.6	35.3	28	2	8	179239	1.64
ION PRODUCTS AVP	1357.8	3	82.0	16	6.0	5.3	55.3	NM	21	NA	9	10279	2.06
OROX CLX ⁽⁶⁾	989.0**	-4	79.0	-25	8.0	10.3	19.5	22.7	21	15	9	7643	1.54
ILGATE-PALMOLIVE CL	2292.6	2	267.9	12	11.7	10.7	26.9	73.5	32	-3	37	31648	1.76
AL DL	401.5	8	13.1	-39	3.3	5.8	NM	-6.4	NM	19	NA	1243	-0.21
OLAB ECL	580.9	10	44.4	4	7.6	8.1	21.9	26.5	24	12	16	4832	1.60
ITEE LAUDER EL ⁽⁶⁾	1101.7	6	65.1	8	5.9	5.8	16.5	23.4	31	32	27	9700	1.32
LETTE G	1763.0	-7	182.0	-30	10.3	13.8	21.6	35.9	41	-7	-1	29989	0.70

CORPORATE SCOREBOARD

COMPANY SYMBOL	SALES		PROFITS		RETURN				5-YEAR GROWTH			MARKET VALUE SHARES OUTSTANDING 5-3 \$ MIL	MON EARN PER SHA
	1ST QUARTER 2001 \$ MIL	CHANGE FROM 2000 %	1ST QUARTER 2001 \$ MIL	CHANGE FROM 2000 %	MARGINS		ON INVESTED CAPITAL %	ON COMMON EQUITY %	P-E 5-3	COMMON EQUITY %	EARNINGS PER SHARE %		
PROCTER & GAMBLE PG ⁽⁶⁾	9511.0	-3	893.0	19	9.4	7.7	18.2	28.7	24	2	8	83545	2.6
REVLON REV	323.3	-28	-47.0	NM	NM	NM	NM	NM	NM	NA	NA	360	-2.9
(E) TOBACCO													
GROUP COMPOSITE	21071.1	12	2339.9	5	11.1	11.8	18.9	39.1	13	12	10	125923	3.7
PHILIP MORRIS MO	17982.0	15	2096.0	4	11.7	12.9	22.9	56.8	14	2	10	113979	3.8
R.J. REYNOLDS TOBACCO HOLDINGS RJR	1950.0	2	100.0	27	5.1	4.1	3.8	4.4	16	-11	NA	6050	3.0
UNIVERSAL UVV ⁽⁶⁾	756.2	-24	35.9	-7	4.7	3.8	17.9	21.8	10	6	35	1088	3.7
UST UST	383.0	4	108.0	6	28.2	27.7	35.4	165.5	11	-4	4	4806	2.7
7 CONTAINERS & PACKAGING													
INDUSTRY COMPOSITE	12939.2	1	189.4	-56	1.5	3.3	3.6	4.9	31	15	-3	24242	0.5
(A) GLASS, METAL & PLASTIC													
GROUP COMPOSITE	4257.6	-1	19.6	-82	0.5	2.5	-1.6	-10.9	NM	10	26	3143	-1.4
BALL BLL	850.0	0	18.5	-8	2.2	2.4	6.9	10.0	20	3	55	1206	2.7
CROWN CORK & SEAL CCK	1658.0	-2	-50.0	NM	NM	1.4	NM	-11.7	NM	3	NA	534	-1.9
OWENS-ILLINOIS OI	1306.1	-3	48.9	-17	3.7	4.4	NM	-21.1	NM	28	NA	1138	-2.0
SILGAN HOLOINGS SLGN	443.5	6	2.2	-58	0.5	1.3	8.8	NM	8	NA	0	265	1.8
(B) PAPER													
GROUP COMPOSITE	8681.6	3	169.8	-47	2.0	3.8	6.4	10.1	17	17	-5	21099	1.2
BEMIS BMS	577.4	13	29.7	0	5.1	5.8	11.2	15.9	15	9	7	1962	2.4
MAIL-WELL MWL	589.9	5	3.6	-77	0.6	2.8	4.6	3.4	17	36	10	229	0.2
PACKAGING CORP. OF AMERICA PKG	454.7	-4	28.1	12	6.2	5.3	14.1	25.6	9	NA	NA	1491	1.6
PACTIV PTV	695.0	-6	29.0	-15	4.2	4.6	5.3	7.3	19	NA	NA	2135	0.7
POTLATCH PCH	444.0	-6	-31.4	NM	NM	0.5	NM	-8.7	NM	-3	NA	977	-2.3
ROCK-TENN RKT ⁽³⁾	367.4	-1	7.3	NM	2.0	NM	5.3	5.3	19	5	NA	376	0.6
SEALEO AIR SEE	758.3	2	34.6	-37	4.6	7.4	7.3	25.3	22	47	-1	3256	1.7
SMURFIT-STONE CONTAINER SSCC	2183.0	7	19.0	-53	0.9	2.0	5.3	7.9	17	NA	-4	3425	0.8
SONOCO PRODUCTS SON	632.8	-6	4.7	-90	0.7	6.7	10.1	15.8	18	2	2	2111	1.2
TEMPLE-INLANO TIN	1053.0	-1	12.0	-78	1.1	5.2	8.9	8.3	17	-2	0	2497	3.0
WESTVACO W ⁽²⁾	926.1	16	33.3	-34	3.6	6.3	6.1	10.1	11	1	-7	2640	2.3
8 DISCOUNT & FASHION RETAILING													
INDUSTRY COMPOSITE	200235.9	9	6267.4	-21	3.1	4.3	9.2	12.7	37	13	18	629866	0.9
ABERCROMBIE & FITCH ANF ⁽¹¹⁾	439.4	21	77.2	1	17.6	21.1	37.4	37.4	22	144	59	3324	1.5
ALBERTO-CULVER ACV ⁽³⁾	622.6	12	25.9	14	4.2	4.1	11.6	15.2	23	11	13	2322	1.8
AMAZON.COM AMZN	700.4	22	-223.6	NM	NM	NM	NM	NM	NM	NM	NA	6011	-3.7
AMERICAN EAGLE OUTFITTERS AEOS ⁽¹¹⁾	423.7	48	49.1	32	11.6	13.0	23.9	25.5	29	39	88	2631	1.3
AMES DEPARTMENT STORES AMES ⁽¹¹⁾	1330.6**	4	-145.2	NM	NM	7.5	NM	-58.9	NM	48	NA	85	-7.9
ANN TAYLOR STORES ANN ⁽¹¹⁾	343.6**	16	3.8	-76	1.1	5.4	8.2	9.1	17	12	62	857	1.7
AUTOZONE AZO ⁽⁴⁾	974.0	5	31.7	-19	3.3	4.2	13.2	29.4	15	10	16	3514	2.0
BARNES & NOBLE BKS ⁽¹¹⁾	1605.4	21	-34.0	NM	NM	7.8	NM	-6.7	NM	17	NA	2086	-0.8
BJ'S WHOLESALE CLUB BJ ⁽¹¹⁾	1506.0	18	54.8	15	3.6	3.7	19.5	19.8	26	25	27	3285	1.7
BORDERS GROUP BGP ⁽¹¹⁾	1192.1	11	75.7	-23	6.4	9.2	9.5	8.7	21	14	7	1504	0.9
BURLINGTON COAT FACTORY BCF ⁽⁷⁾	722.7	5	36.1	4	5.0	5.1	12.6	11.8	12	10	19	929	1.7
CDW COMPUTER CENTERS CDWC	987.2	14	40.5	15	4.1	4.1	27.4	27.4	22	42	48	3485	1.8
CHARMING SHOPPES CHRS ⁽¹¹⁾	434.7	25	9.1	7	2.1	2.5	9.4	10.7	12	-4	NA	575	0.4
CLAIRE'S STORES CLE ⁽¹¹⁾	328.9	7	30.0	-27	9.1	13.4	13.0	16.3	15	23	17	976	1.3
COLE NATIONAL CNJ ⁽¹¹⁾	298.8	12	3.7	NM	1.3	NM	NM	1.5	67	118	-36	146	0.1
CONSOLIDATED STORES CNS ⁽¹¹⁾	1111.9	14	68.2	7	6.1	6.5	8.9	10.6	13	36	-2	1235	0.8
COSTCO WHOLESALE COST ⁽⁴⁾	8306.3**	7	176.6	-3	2.1	2.3	11.8	13.7	26	23	23	15923	1.3
CSK AUTO CAO ⁽¹¹⁾	352.1	7	-5.1	NM	NM	NM	8.8	3.5	35	NA	NA	175	0.1
OILLARO'S DDS ⁽¹¹⁾	2723.0**	2	59.0	127	2.2	1.0	4.3	4.0	16	4	-9	1481	1.0
DOLLAR GENERAL DG ⁽¹¹⁾	1442.7	22	71.4	-21	4.9	7.7	15.9	19.2	25	22	21	5191	0.6
DOLLAR TREE STORES DLTR	387.3	18	10.8	-23	2.8	4.3	22.0	22.3	22	63	40	2532	1.0
ELECTRONICS BOUTIQUE HOLDINGS ELBO ⁽¹¹⁾	334.0	6	13.1	-16	3.9	4.9	12.7	11.3	41	78	23	603	0.6
EMERGE INTERACTIVE EMRG	325.2	751	-10.0	NM	NM	NM	NM	-31.2	NM	NA	NA	85	-1.0
FAMILY DOLLAR STORES FDO ⁽⁴⁾	1037.4	21	60.5	10	5.8	6.4	19.8	20.6	25	15	26	4418	1.0
FEDERATED DEPARTMENT STORES FD ⁽¹¹⁾	6115.0**	2	332.0	-26	5.4	7.5	-1.6	-3.2	NM	8	NA	8530	-0.9
FINLAY ENTERPRISES FNLY ⁽¹¹⁾	420.5	9	29.1	159	6.9	2.9	13.2	19.7	4	78	-6	117	2.5
FOOTSTAR FTS	517.2	18	-4.1	NM	NM	0.6	27.6	16.6	14	-7	10	716	2.6
GAP GPS ⁽¹¹⁾	4579.1	19	271.8	-34	5.9	10.7	24.7	30.0	28	11	28	24108	1.0
GOODY'S FAMILY CLOTHING GDYS ⁽¹¹⁾	400.3	2	11.1	NM	2.8	0.2	6.2	6.1	10	19	28	138	0.4
HOME DEPOT HD ⁽¹¹⁾	10463.0	14	465.0	-20	4.4	6.3	15.5	17.2	44	25	29	112725	1.1
HOMEBASE HBI ⁽¹¹⁾	332.4	2	-60.4	NM	NM	NM	NM	-21.9	NM	-8	NA	56	-1.8
INSIGHT ENTERPRISES NSIT	557.5	19	14.3	16	2.6	2.6	19.7	20.5	17	70	55	959	1.4
INTIMATE BRANOS IBI ⁽¹¹⁾	1937.5	5	221.6	-21	11.4	15.2	58.7	65.0	19	17	18	7940	0.8
JO-ANN STORES JAS.A ⁽¹¹⁾	496.4	9	-9.7	NM	NM	4.4	NM	-5.5	NM	12	NA	80	-0.7
KMART KM ⁽¹¹⁾	11636.0	5	249.0	-40	2.1	3.7	NM	-4.0	NM	4	NA	5186	-0.4
KOHL'S KSS ⁽¹¹⁾	2223.0	38	178.5	48	8.0	7.5	13.0	16.9	55	41	34	19996	1.1
LANOS' ENO LE ⁽¹¹⁾	538.6	11	31.8	12	5.9	5.9	10.8	11.0	26	9	2	878	1.1

CORPORATE SCOREBOARD

COMPANY SYMBOL	SALES		PROFITS		RETURN				5-YEAR GROWTH			MARKET VALUE SHARES OUTSTANDING \$ MIL.	12 MONTHS' EARNINGS PER SHARE
	1ST QUARTER 2001 \$ MIL.	CHANGE FROM 2000 %	1ST QUARTER 2001 \$ MIL.	CHANGE FROM 2000 %	MARGINS		ON INVESTED CAPITAL %	ON COMMON EQUITY %	P-E 5-3	COMMON EQUITY %	EARNINGS PER SHARE %		
					1ST QUARTER 2001 %	1ST QUARTER 2000 %							
WITEO LTD (11)	3521.9	7	238.2	-25	6.8	9.6	20.6	18.5	18	-6	5	7253	0.96
WE'S LOW (11)	4543.1	20	140.8	-5	3.1	3.9	10.9	14.7	30	26	25	24114	2.12
WY DEPARTMENT STORES MAY (11)	5004.0**	8	518.0	1	10.4	11.1	12.0	21.8	14	-2	9	11116	2.63
W'S WEARHOUSE MW (11)	446.9	12	38.3	26	8.6	7.7	15.7	17.1	12	35	27	1032	2.00
WCHAELS STORES MIKE (11)	815.5	21	50.1	7	6.1	6.9	10.9	11.4	14	11	2	1129	2.35
WIMAN MARCUS GROUP NMG.A (5)	900.8	3	39.9	-3	4.4	4.7	13.2	15.6	11	100	21	1608	3.00
WROSTROM JWN (11)	1685.1**	7	27.0	-59	1.6	4.2	6.1	8.3	24	-4	1	2469	0.78
WICE DEPOT ODP	3017.9	-2	56.3	-48	1.9	3.6	-0.2	-0.2	NM	13	-15	3100	0.03
WICEMAX OMX (11)	1423.2	2	-85.0	NM	NM	1.7	NM	-13.8	NM	0	NA	412	-1.20
WYLESS SHOESOURCE PSS (11)	700.1	16	13.9	-9	2.0	2.5	NA	30.2	12	-7	17	1411	5.16
WCONNECTION PCCC	301.8	-10	2.4	-66	0.8	2.1	18.4	19.0	14	72	48	349	1.04
WNNY (J.C.) JCP (11)	9573.0	-1	-323.0	NM	NM	NM	NM	-8.2	NM	3	NA	5349	-2.29
W P BOYS-MANNY, MOE & JACK P8Y (11)	547.4	-1	1.3	NM	0.2	NM	NM	-8.9	NM	4	-31	261	-1.00
WSMART PETM (11)	610.3	7	-27.2	NM	NM	NM	NM	-11.1	NM	9	NA	511	-0.28
WSS STORES ROST (11)	779.1	12	45.2	6	5.8	6.1	30.9	32.5	12	13	31	1759	1.82
WKS SKS (11)	2123.5**	4	55.3	-54	2.6	5.9	4.2	3.3	23	75	1	1710	0.53
WARS, ROEBUCK S	8857.0	-1	176.0	-25	2.0	2.6	11.7	19.9	10	11	8	12034	3.76
WERWIN-WILLIAMS SHW	1158.4	-5	36.9	-10	3.2	3.3	0.8	0.8	NM	5	-28	3368	0.08
WOPKO STORES SKO (11)	1137.4	10	-47.3	NM	NM	4.6	NM	-7.6	NM	9	NA	230	-1.72
WIEGEL SPGLA	749.6	-3	-12.2	NM	NM	2.6	8.7	11.5	8	10	NA	789	0.71
WORTS AUTHORITY TSA (11)	421.1	-1	12.9	NM	3.1	NM	7.9	4.8	12	-10	NA	83	0.21
WAPLES SPLS (11)	3114.8	18	-111.7	NM	NM	4.5	NA	3.4	NM	27	1	7577	0.13
WLBOTS TL8 (11)	488.9**	28	33.0	116	6.8	4.0	18.1	20.9	23	1	17	2610	1.80
WROGET TGT (11)	12324.0**	13	552.0	6	4.5	4.8	12.6	19.4	28	16	34	35022	1.38
WFANY TIF (11)	576.4**	2	84.7	0	14.7	15.0	17.2	20.6	27	27	34	4882	1.26
W (TJX) (11)	2751.3	9	135.2	-1	4.9	5.4	35.9	44.2	17	16	54	8849	1.86
WYS 'R' US TOY (11)	4799.0	-5	251.0	7	5.2	4.7	10.0	11.8	13	2	1	4932	1.88
WBLUE CITY DEPARTMENT STORES VCD (11)	669.2**	29	-22.9	NM	NM	3.9	NM	-40.7	NM	9	-4	280	-3.03
WNATOR GROUP Z (11)	1256.0	7	42.0	-52	3.3	7.4	9.4	10.6	18	-5	-30	1904	0.77
WAL-MART STORES WMT (11)	56556.0	10	2004.0	5	3.5	3.7	15.2	20.1	38	16	20	237357	1.40
WLSONS THE LEATHER EXPERTS WLSN (11)	381.5	20	61.1	18	16.0	16.3	21.8	24.1	10	51	41	403	2.45
WLE ZLC (5)	855.3	16	71.5	-15	8.4	11.4	11.7	11.8	12	15	28	1161	2.77
ELECTRICAL & ELECTRONICS													
INDUSTRY COMPOSITE	60890.1	6	234.9	-96	0.4	11.4	8.1	7.8	39	20	11	673119	0.76
(1) ELECTRICAL PRODUCTS													
GROUP COMPOSITE	8311.6	3	567.0	-12	6.8	8.0	14.2	19.3	16	-1	6	45224	3.24
WOPER INDUSTRIES CBE	1095.1	5	56.4	-33	5.2	8.1	12.5	17.3	10	-6	8	3419	3.51
WIERSON ELECTRIC EMR (3)	4103.3	5	358.7	2	8.7	9.1	18.0	21.9	19	5	10	27664	3.39
WIBBELL HUB.8	344.1	-5	21.1	-40	6.1	9.7	16.0	16.1	13	3	4	1563	2.06
WATIONAL SERVICE INDUSTRIES NSI (4)	607.4	0	15.8	-22	2.6	3.3	10.5	12.9	11	-3	7	976	2.13
WICKWELL INTERNATIONAL ROK (3)	1163.0	-1	71.0	-30	6.1	8.7	13.7	16.3	14	-10	2	7790	3.13
WWITH (A.O.) AOS	318.2	-8	8.5	-40	2.7	4.1	6.1	8.0	13	3	8	452	1.52
WXP SPW	680.4	8	35.4	-6	5.2	6.0	8.4	29.6	18	-3	11	3360	6.19
(2) ELECTRONICS													
GROUP COMPOSITE	13151.5	-6	-520.5	NM	NM	4.3	-0.6	-1.4	NM	11	-4	117370	-0.11
WAYA AV (3)	1852.0	-5	-64.0	NM	NM	3.4	NM	-73.1	NM	NA	NA	4343	-2.08
WARRIS HRS (6)	479.3	5	11.1	NM	2.3	NM	1.0	0.8	NM	3	-31	1909	0.11
WIGHES ELECTRONICS GMH	1893.0	11	-97.9	NM	NM	NM	NM	-4.4	NM	3	NA	29759	-0.32
W3 COMMUNICATIONS HOLDINGS LLL	461.9	22	14.2	30	3.1	2.9	8.3	11.8	32	84	58	2615	2.45
WOTOROLA MOT	7752.0	-12	-533.0	NM	NM	5.1	1.7	2.0	NM	11	-10	34752	0.14
WIALCOMM QCOM (3)	713.3	-2	149.1	-25	20.9	27.4	1.7	1.6	NM	46	78	43992	0.09
(3) INSTRUMENTS													
GROUP COMPOSITE	7178.4	16	580.1	26	8.1	7.4	13.5	15.7	23	26	8	60100	1.68
WILENT TECHNOLOGIES A (2)	2841.0	26	179.0	37	6.3	5.8	14.5	14.5	22	NA	NA	17563	1.74
WPLIED BIOSYSTEMS GROUP ABI (6)	439.8	19	57.7	3	13.1	15.2	21.6	22.0	32	NA	33	6717	1.00
WICKMAN COULTER BEC	432.7	0	23.4	11	5.4	4.8	14.2	33.4	18	-4	16	2208	2.05
WINAHER DHR	1005.3	16	82.6	15	8.2	8.2	13.4	17.3	23	28	20	7669	2.30
WIA-TENCOR KLAC (6)	528.8	28	91.4	25	17.3	17.8	21.1	21.1	25	33	-1	9418	2.06
WIRKINELMER PKI	425.7	6	23.5	45	5.5	4.0	8.9	12.8	35	15	6	3130	1.81
WIKTRONIX TEK (7)	326.9	18	41.0	NM	12.5	NM	12.2	13.1	18	6	-31	2355	1.41
WIRADYNE TER	605.2	-2	59.7	-36	9.9	15.2	27.0	25.9	14	16	25	6376	2.67
WIERMO ELECTRON TMO	573.1	-1	21.8	51	3.8	2.5	2.6	2.7	66	12	-20	4664	0.39
(4) SEMICONDUCTORS & OTHER COMPONENTS													
GROUP COMPOSITE	32248.7	10	-391.6	NM	NM	16.6	9.3	8.0	36	29	17	450425	0.80
WST MFG. ACTM	445.3	94	4.8	-23	1.1	2.7	6.6	12.4	11	45	1	286	1.55
WVANCED MICRO DEVICES AMD	1188.7	9	124.8	-34	10.5	17.3	20.4	28.7	12	6	NA	10305	2.77
WERE SYSTEMS AGR.A (3)	1191.0	12	-148.0	NM	NM	6.1	-2.3	-6.6	NM	NA	NA	NA	-0.37
WIKOR TECHNOLOGY AMKR	480.6	-13	-69.2	NM	NM	6.7	5.8	3.8	77	132	22	3382	0.29

CORPORATE SCOREBOARD

COMPANY SYMBOL	SALES		PROFITS		MARGINS		RETURN			5-YEAR GROWTH			MARKET VALUE SHARES OUTSTANDING 5-3 \$ MIL.	12 MONTH EARNINGS PER SHARE
	1ST QUARTER 2001 \$ MIL.	CHANGE FROM 2000 %	1ST QUARTER 2001 \$ MIL.	CHANGE FROM 2000 %	1ST QUARTER 2001 %	1ST QUARTER 2000 %	ON INVESTED CAPITAL %	ON COMMON EQUITY %	P-E 5-3	COMMON EQUITY %	EARNINGS PER SHARE			
AMPHENOL APH	316.7	6	28.5	41	9.0	6.8	21.9	397.3	17	NA	28	1909	2.7	
ANALOG DEVICES ADI ⁽²⁾	772.3	58	190.4	105	24.7	19.0	18.6	27.7	26	26	24	17181	1.8	
ATMEL ATML	525.9	23	56.0	34	10.7	9.8	12.1	14.5	24	18	13	6451	0.5	
AVX AVX ⁽⁹⁾	600.9	20	124.8	76	20.8	14.2	45.5	46.2	6	15	0	3175	3.2	
BENCHMARK ELECTRONICS 8HE	431.9	24	5.1	159	1.2	0.6	6.1	5.6	23	49	6	525	1.1	
BROADCOM BRCM	310.5	62	-356.9	NM	NM	20.2	NM	-21.9	NM	559	NA	10699	-4.7	
FAIRCHILD SEMICONDUCTOR INTL. FCS	385.3	-4	1.6	-97	0.4	12.4	NM	26.7	8	155	NA	1845	2.2	
INTEL INTC	6677.0	-16	485.0	-82	7.3	33.7	21.5	22.5	25	25	21	204320	1.2	
JABIL CIRCUIT J8L ⁽⁴⁾	1211.2	45	40.7	20	3.4	4.1	12.6	12.6	35	77	63	5948	0.9	
JOS UNIPHASE JDSU ⁽⁶⁾	920.1	133	-1293.1	NM	NM	NM	NM	-5.8	NM	256	NA	20979	-3.7	
KEMET KEM ⁽⁹⁾	338.0	31	78.4	106	23.2	14.7	34.6	39.8	5	31	24	1713	4.0	
LSI LOGIC LSI	517.2	-16	-31.2	NM	NM	14.0	4.0	4.8	60	14	-3	6726	0.3	
MANUFACTURERS SERVICES MSV	528.7	59	1.1	NM	0.2	NM	6.3	-4.2	NM	NA	NA	188	-0.1	
MICRON TECHNOLOGY MU ⁽⁴⁾	1065.7	-8	-4.1	NM	NM	14.6	17.3	18.2	19	24	10	24693	2.2	
MOLEX MOLX ⁽⁶⁾	599.8	6	60.7	5	10.1	10.2	14.9	14.5	30	9	11	7617	1.3	
NATIONAL SEMICONDUCTOR NSM ⁽⁷⁾	475.6	-13	39.2	-88	8.2	59.7	24.0	24.2	12	-2	17	4775	2.3	
ON SEMICONDUCTOR ONNN	360.5	-26	-43.0	NM	NM	5.2	7.1	10.3	62	NA	NA	1071	0.1	
SANMINA SANM ⁽³⁾	1191.1	26	62.2	6	5.2	6.2	NA	14.1	49	91	37	9768	0.6	
SCI SYSTEMS SCI ⁽⁶⁾	2016.6	-9	-5.8	NM	NM	2.2	9.3	10.7	25	32	25	3867	1.0	
SOLECTRON SLR ⁽⁴⁾	5418.5	85	121.9	26	2.3	3.3	6.5	10.7	27	50	30	16840	0.9	
TEXAS INSTRUMENTS TXN	2528.0	-8	230.0	-49	9.1	16.3	20.0	22.2	24	26	24	65915	1.6	
THOMAS & BETTS TN8	396.9	-16	-5.0	NM	NM	1.8	NM	-23.7	NM	8	NA	1164	-3.5	
VIASYSTEMS GROUP VG	389.2	1	-18.7	NM	NM	NM	5.6	2.2	8	NA	NA	638	0.5	
VISHAY INTERTECHNOLOGY VSH	558.5	4	90.1	21	16.1	13.8	26.8	29.1	6	11	24	3328	3.8	
XILINX XLNX ⁽⁹⁾	407.0	33	-162.1	NM	NM	NM	1.6	1.8	NM	44	0	15117	0.1	

10 FOOD

INDUSTRY COMPOSITE	89561.0	6	2386.6	-12	2.7	3.2	11.3	18.4	23	5	5	221984	1.1
(A) FOOD DISTRIBUTION													
GROUP COMPOSITE	13142.3	7	58.8	-69	0.4	1.5	10.8	16.1	30	5	7	21755	0.8
INTERNATIONAL MULTIFOODS IMC (10)	679.5	14	2.7	-61	0.4	1.2	7.2	8.3	16	-3	-16	357	1.1
NASH FINCH NAFC	908.0**	3	3.3	45	0.4	0.3	6.7	9.0	14	-6	-5	230	1.4
PERFORMANCE FOOD GROUP PFGC	723.5	25	6.3	63	0.9	0.7	7.0	8.0	30	38	17	995	0.9
SUPERVALU SVU (10)	5486.8	-1	-92.8	NM	NM	1.3	5.1	4.6	22	7	-7	1807	0.6
SYSCO SY (6)	5344.5	13	139.4	37	2.6	2.2	19.4	30.8	33	3	14	18366	0.8
(B) FOOD PROCESSING													
GROUP COMPOSITE	43951.3	6	1849.5	-3	4.2	4.6	13.8	23.9	21	-1	4	149588	1.2
ARCHER DANIELS MIOLANO ADM (6)	5130.3	15	93.1	-10	1.8	2.3	7.2	6.1	19	1	-18	7383	0.6
CAMPBELL SOUP CPB (5)	1957.0	2	271.0	-4	13.8	14.7	44.2	NM	19	-47	3	12423	1.5
CHIKITA BRANOS INTERNATIONAL CQB	577.3	-12	4.1	-88	0.7	5.3	NM	-43.4	NM	-7	NA	99	-2.1
CONAGRA FOODS CAG (7)	6429.2	9	98.5	-31	1.5	2.4	8.8	12.9	20	5	3	11113	1.0
CORN PRODUCTS INTERNATIONAL CPD	454.6	2	12.7	253	2.8	0.8	6.4	6.2	15	-1	26	872	1.6
DEAN FOODS DF (7)	1093.3	12	16.7	-34	1.5	2.6	9.2	14.0	14	5	4	1336	2.7
DEL MONTE FOODS DLM (6)	383.4	9	10.7	-19	2.8	3.7	NM	317.0	4	NA	NA	444	2.1
DOLE FOOD DOL	1111.1	-1	34.7	-5	3.1	3.2	7.2	11.9	13	1	-18	843	1.1
EARTHGRAINS EGR (9)	597.2	25	5.6	-26	0.9	1.6	2.7	1.9	80	4	44	1014	0.3
GENERAL MILLS GIS (7)	1701.6	5	157.5	3	9.3	9.5	26.5	NM	19	NM	15	11386	2.1
HEINZ (H.J.) HNZ (8)	2269.6	-1	270.5	58	11.9	7.5	25.9	47.5	18	-10	7	13602	2.1
HERSHEY FOODS HSY	1080.3	9	78.9	11	7.3	7.2	16.3	27.8	24	1	11	8162	2.4
HORMEL FOODS HRL (2)	947.5	5	41.5	-5	4.4	4.9	17.0	18.7	16	3	14	2705	1.2
IBP IBP	4126.6	4	19.9	-41	0.5	0.9	7.7	7.4	13	13	-4	1753	1.3
INTERSTATE BAKERIES IBC (7)	1039.0	0	7.7	-62	0.7	2.0	10.2	14.1	15	20	32	713	0.9
KELLOGG K	1707.3	-3	92.5	-43	5.4	9.2	32.8	66.3	20	-12	0	10263	1.2
MCCORMICK MKC (11)	533.5	15	26.6	9	5.0	5.3	20.2	36.2	19	-6	17	2617	2.0
PILGRIM'S PRIDE CHX (3)	541.6	45	-9.8	NM	NM	2.4	5.3	9.1	13	20	11	420	0.7
QUAKER OATS OAT	1226.6	5	109.5	NM	8.9	0.2	48.1	107.9	29	-28	-7	12878	3.3
RALSTON PURINA RAL (3)	706.1	2	54.4	-64	7.7	21.9	17.7	54.7	31	4	11	8747	0.9
SARA LEE SLE (6)	4308.0	3	241.0	-3	5.6	6.0	20.7	57.5	19	-26	11	16641	1.0
SMITHFIELD FOODS SFD (6)	1537.4	12	80.8	362	5.3	1.3	10.7	18.7	9	35	23	1854	3.6
STARBUCKS SBUX (3)	629.3	24	32.2	38	5.1	4.6	9.3	9.6	61	30	24	7173	0.9
SUIZA FOODS SZA	1474.4	6	23.5	14	1.6	1.5	7.8	19.1	12	115	18	1247	3.8
TYSON FOODS TSN (3)	1827.5	2	-6.0	NM	NM	2.0	3.7	3.7	39	9	-4	3048	0.3
WRIGLEY (WM.) JR. WY	561.6	12	81.5	9	14.5	14.8	28.7	29.6	33	8	9	10852	1.4
(C) FOOD RETAILING													
GROUP COMPOSITE	32467.4	5	478.3	-22	1.5	2.0	7.0	9.8	27	23	9	50641	1.2
ALBERTSON'S ABS (11)	9544.0	4	220.0	-17	2.3	2.7	8.5	13.4	18	27	5	13426	1.8
DELHAIZE AMERICA DZA	3603.1	45	27.9	-57	0.8	2.6	6.7	4.8	NA	16	3	NA	0.7
GREAT ATLANTIC & PACIFIC TEA GAP (10)	2554.7	6	-10.8	NM	NM	0.3	NM	3.1	NM	2	-31	466	0.6
INGLES MARKETS IMKTA (3)	475.2**	2	3.2	-51	0.7	1.4	6.4	7.5	15	7	7	267	0.7
PATHMARK STORES PTMK (11)	1056.0	10	-48.5	NM	NM	NM	NM	-23.6	NA	NA	NA	574	N

CORPORATE SCOREBOARD

COMPANY SYMBOL	SALES		PROFITS		RETURN				5-YEAR GROWTH			MARKET VALUE SHARES OUTSTANDING \$ MIL.	12 MONTHS' EARNINGS PER SHARE
	1ST QUARTER 2001 \$ MIL.	CHANGE FROM 2000 %	1ST QUARTER 2001 \$ MIL.	CHANGE FROM 2000 %	MARGINS		ON INVESTED CAPITAL %	ON COMMON EQUITY %	P-E 5-3	COMMON EQUITY %	EARNINGS PER SHARE %		
					1ST QUARTER 2001 %	1ST QUARTER 2000 %							
PENN TRAFFIC PNFT ⁽¹⁾	691.7**	10	-21.3	NM	NM	NM	NM	-37.9	NM	NA	NA	123	-4.97
RUOICK RDK ⁽³⁾	691.9	4	-7.3	NM	NM	2.0	4.6	6.0	23	8	5	645	0.61
SAFEWAY SWY	7666.1	8	283.9	17	3.7	3.4	12.0	21.0	25	48	26	27725	2.21
7-ELEVEN SE	2255.2**	6	2.3	-84	0.1	0.7	7.5	114.5	12	NA	-10	1075	0.83
SMART & FINAL SMF	424.2	6	0.9	37	0.2	0.2	6.9	4.3	28	12	-24	318	0.39
WEIS MARKETS WMK	489.1	-6	17.2	-4	3.5	3.4	7.6	7.7	20	4	0	1437	1.75
WINN-DIXIE STORES WIN ⁽⁶⁾	3016.3	-6	10.7	4	0.4	0.3	NM	-26.5	NM	-5	NA	4585	-1.43
1 FUEL													
INDUSTRY COMPOSITE	160171.1	17	13983.9	89	8.7	5.4	16.0	24.5	14	13	10	639467	4.50
(A) COAL, OIL & GAS													
GROUP COMPOSITE	149179.1	17	13208.4	86	8.9	5.6	17.0	26.7	12	12	12	543060	5.30
AMERAAO HESS AHC	4182.0	48	337.0	50	8.1	7.9	19.4	29.3	6	4	66	7276	12.70
ANADARKO PETROLEUM APC	3051.0	362	664.0	NM	21.8	7.7	10.4	21.7	10	36	42	15329	6.40
APACHE APA	801.6	80	282.2	141	35.2	26.2	14.9	25.1	8	22	57	7186	6.92
ARCH COAL ACI	375.4	6	6.1	NM	1.6	NM	NM	2.7	NM	-8	NA	1260	0.20
ASHLAND ASH ⁽³⁾ †	1676.0	-9	26.0	4	1.6	1.4	10.2	15.5	9	9	80	2829	4.41
BURLINGTON RESOURCES 8R	1143.0	61	333.0	332	29.1	10.9	16.8	24.8	10	11	-40	9405	4.32
CHEVRON CHV	10964.0	5	1600.0	53	14.6	10.0	19.9	28.8	10	6	22	58785	8.87
CONOCO COC.8	10535.0**	24	616.0	54	5.8	4.7	19.1	37.7	9	NA	21	18391	3.34
CONSOL ENERGY CNX ⁽⁶⁾	590.7**	10	100.8	339	17.1	4.3	36.4	52.9	17	NA	-9	2827	2.17
DEVON ENERGY DVN	1023.6	83	350.8	234	34.3	18.8	13.9	31.2	7	67	35	6827	7.27
EOG RESOURCES EOG	596.7	130	215.2	419	36.1	16.0	23.8	45.4	9	-1	35	4923	4.70
EXXON MOBIL XOM	57278.0	6	4960.0	64	8.7	5.6	19.1	25.3	17	12	5	298337	5.11
FRONTIER OIL FTO	431.1	-4	4.5	NM	1.0	NM	23.5	57.4	6	22	NA	292	1.73
KERR-MCGEE KMG	1057.5	19	355.0	92	33.6	20.9	20.3	36.6	7	10	6	6345	9.83
MITCHELL ENERGY & DEVELOPMENT MND	655.1	109	122.9	184	18.8	13.8	31.7	54.3	8	0	32	2509	6.67
MURPHY OIL MUR	1189.4	17	97.8	142	8.2	4.0	18.6	28.3	9	2	18	3340	7.82
OCCIDENTAL PETROLEUM OXY	4475.0	74	511.0	89	11.4	10.5	16.3	37.9	6	5	19	10548	4.89
PENNZOIL-QUAKER STATE PZL	568.9	-3	8.7	NM	1.5	NM	3.6	4.0	72	46	NA	1128	0.20
PHILLIPS PETROLEUM P	4868.0	3	490.0	96	10.1	5.3	15.0	34.5	7	10	11	14376	8.16
SUNOCO SUN	3121.0	12	106.0	58	3.4	2.4	17.7	25.6	7	19	4	3271	5.19
TESORO PETROLEUM TSO	1227.3	16	21.7	133	1.8	0.9	9.6	14.6	7	17	-14	425	2.07
EXACO TX	14134.0**	25	833.0	45	5.9	5.1	14.2	21.2	13	7	10	37164	5.13
TOSCO TOS	6406.4	38	86.8	16	1.4	1.6	12.3	20.7	12	30	35	6234	3.53
ULTRAMAR DIAMOND SHAMROCK UDS	4214.1	16	136.7	98	3.2	1.9	14.9	36.5	7	16	27	3418	6.04
UNOCAL UCL	2214.0	19	292.0	135	13.2	6.7	16.0	32.8	10	1	2	8677	3.58
USX-MARATHON GROUP MRO	8631.0**	12	515.0	103	6.0	3.3	13.6	14.3	13	NA	-7	9288	2.25
VALERO ENERGY VLO	3769.3	29	136.1	343	3.6	1.1	16.0	29.1	6	6	8	2670	7.19
(B) PETROLEUM SERVICES													
GROUP COMPOSITE	10991.9	25	775.5	166	7.1	3.3	7.5	8.9	48	18	-5	96407	1.06
BAKER HUGHES BHI	1228.5	-1	70.3	356	5.7	1.2	4.5	5.2	77	17	-26	11746	0.46
BJ SERVICES BJS ⁽³⁾	549.7**	41	80.8	175	14.7	7.5	17.1	18.3	30	14	42	6192	2.53
COOPER CAMERON CAM	334.8**	-1	14.3	13	4.3	3.8	3.8	3.5	NM	14	-25	3321	0.52
HALLIBURTON HAL	3144.0**	10	86.0	219	2.7	0.9	7.3	6.3	72	21	-18	17294	0.56
NABORS INDUSTRIES N8R	513.8	84	83.1	364	16.2	6.4	8.1	10.5	43	39	-2	7959	1.27
NATIONAL-OILWELL NOI	360.3	37	21.5	379	6.0	1.7	3.9	3.9	91	53	-29	2697	0.37
NOBLE AFFILIATES N8L	560.0	108	105.9	294	18.9	10.0	19.8	27.9	8	10	60	2188	4.78
SCHLUMBERGER SL8	2909.4	36	235.9	73	8.1	6.4	8.2	9.9	43	11	-10	35381	1.44
SMITH INTERNATIONAL SII	865.3	38	34.2	202	4.0	1.8	10.3	11.7	40	23	-3	3776	1.91
WEATHERFORD INTERNATIONAL WFT	526.2	33	43.5	335	8.3	2.5	-0.2	-0.4	NM	50	NA	5853	-0.06
2 HEALTH CARE													
INDUSTRY COMPOSITE	139986.3	14	12163.2	15	8.7	8.6	17.6	22.8	38	12	12	1509692	1.35
(A) DRUG DISTRIBUTION													
GROUP COMPOSITE	48681.6	20	663.5	2	1.4	1.6	6.0	11.2	53	24	22	113346	0.81
AMERISOURCE HEALTH AAS ⁽³⁾	3481.0	22	31.5	30	0.9	0.9	16.3	30.3	25	165	18	2745	2.07
BERGEN BRUNSWIG BBC ⁽³⁾	5901.9**	6	28.2	19	0.5	0.4	NM	-61.5	NM	14	NA	2432	-3.55
CARDINAL HEALTH CAH ⁽⁶⁾	12580.1	31	192.9	-3	1.5	2.1	NA	15.7	37	49	24	27786	1.78
CAREMARK RX CMX	1373.9	31	38.6	93	2.8	1.9	NA	NM	32	NA	NA	3465	0.49
CVS CVS	5385.9	14	221.7	16	4.1	4.0	17.0	16.9	29	30	53	21416	1.90
O&K HEALTHCARE RESOURCES DKWD ⁽⁶⁾	490.5	15	3.2	23	0.7	0.6	11.1	16.8	15	47	79	123	1.97
LONGS DRUG STORES LDG ⁽¹¹⁾	1106.5	5	8.0	-66	0.7	2.3	6.3	6.6	25	6	2	1092	1.19
McKESSON HBOC MCK ⁽⁹⁾	11409.1**	23	-175.5	NM	NM	NM	-0.8	-1.2	NM	31	3	9184	-0.15
OMNICARE OCR	523.6	6	18.0	25	3.4	2.9	4.6	4.8	37	32	2	1945	0.57
WALGREEN WAG ⁽⁴⁾	6429.0	15	296.9	24	4.6	4.3	17.8	18.0	51	19	19	43158	0.84
(B) DRUGS & RESEARCH													
GROUP COMPOSITE	43086.5	12	7833.0	17	18.2	17.4	23.2	28.8	40	11	13	1034749	1.32
ABBOTT LABORATORIES ABT †	3559.9	6	96.3	-86	2.7	20.7	23.6	25.5	33	15	11	70819	1.40
ALLERGAN AGN	423.0	8	53.9	24	12.7	11.1	16.5	25.7	46	2	26	10112	1.68

CORPORATE SCOREBOARD

COMPANY SYMBOL	SALES		PROFITS		RETURN				5-YEAR GROWTH			MARKET VALUE SHARES OUTSTANDING \$ MIL.	12 MONTH EARNING PER SHARE
	1ST QUARTER 2001 \$ MIL.	CHANGE FROM 2000 %	1ST QUARTER 2001 \$ MIL.	CHANGE FROM 2000 %	MARGINS		ON INVESTED CAPITAL %	ON COMMON EQUITY %	P-E 5-3	COMMON EQUITY %	EARNINGS PER SHARE %		
					1ST QUARTER 2001 %	1ST QUARTER 2000 %							
ALZA AZA	298.1	48	51.0	84	17.1	13.7	11.1	15.4	44	22	12	10946	1.04
AMERICAN HOME PRODUCTS AHP	3449.2	8	733.6	-58	21.3	54.6	NM	-67.9	NM	-10	NA	75925	-1.46
AMGEN AMGN	901.6	11	304.9	15	33.8	32.7	26.2	25.3	55	20	19	61663	1.08
BRISTOL-MYERS SQUIBB BMY	4689.0	5	1243.0	10	26.5	25.4	38.5	45.9	26	9	17	107542	2.12
FOREST LABORATORIES FRX ⁽⁹⁾	324.3**	26	69.2	148	21.3	10.8	18.8	18.8	53	3	0	11002	1.18
GENENTECH DNA	505.0**	38	32.4	NM	6.4	NM	0.7	0.7	NM	32	NA	26841	0.08
LILLY (ELI) LLY	2805.7	14	806.8	-5	28.8	34.5	36.0	49.9	31	0	19	96033	2.76
MERCK MRK	11345.1	28	1657.3	11	14.6	16.9	30.6	47.1	25	4	17	173693	2.97
PFIZER PFE	7645.0	7	1930.0	NM	25.2	NM	35.0	36.4	46	19	10	266767	0.92
PHARMACIA PHA	4516.0	8	254.0	NM	5.6	NM	7.8	10.2	52	22	-4	64815	0.97
SCHERING-PLOUGH SGP	2319.0	-3	564.0	-10	24.3	26.3	37.4	38.6	24	32	19	55009	1.60
SIGMA-ALDRICH SIAL	305.6	5	36.6	-12	12.0	14.4	14.4	15.6	28	4	3	3582	1.69
(C) HEALTH-CARE SERVICES													
GROUP COMPOSITE	32725.5	10	1307.8	33	4.0	3.3	8.9	11.1	31	8	-4	100247	1.18
COMMUNITY HEALTH SYSTEMS CYH	398.6	29	10.8	NM	2.7	0.3	3.7	2.5	NM	18	NA	2409	0.23
COVENTRY HEALTH CARE CVTY	751.4	22	18.6	58	2.5	1.9	11.4	11.1	16	44	317	1040	1.02
EXPRESS SCRIPTS ESRX	2056.4	39	28.1	31	1.4	1.5	-0.1	-0.2	NM	56	NA	3487	0.05
HCA-THE HEALTHCARE CO. HCA	4501.0	5	326.0	10	7.2	6.9	5.8	5.5	86	-10	-20	20836	0.45
HEALTH MANAGEMENT ASSOCIATES HMA ⁽³⁾	481.1	18	48.7	-3	10.1	12.4	11.4	15.1	26	27	22	4328	0.69
HEALTH NET HNT	2488.1	13	42.4	25	1.7	1.5	12.1	15.5	15	30	-6	2549	1.39
HEALTHSOUTH HRC	1090.5	7	75.3	15	6.9	6.4	7.8	8.2	18	29	-9	5135	0.73
HUMANA HUM	2445.0**	-7	27.0	29	1.1	0.8	8.6	6.9	17	1	6	1623	0.57
LABORATORY CORP. OF AMERICA HOLDINGS LH	525.4	14	43.5	69	8.3	5.6	11.9	11.9	38	8	NA	4903	3.72
MANOR CARE HCR	638.2	12	25.0	NM	3.9	NM	5.9	6.3	39	28	-20	2550	0.63
OXFORD HEALTH PLANS OHP	1078.5**	5	67.6	62	6.3	4.1	60.6	46.2	11	-5	31	2891	2.55
PACIFICARE HEALTH SYSTEMS PHSY	3030.7	7	13.1	-82	0.4	2.6	4.7	4.9	10	25	13	974	2.93
QUEST DIAGNOSTICS DGX	882.6	3	35.7	100	4.0	2.1	10.6	11.2	47	19	NA	5576	2.57
SIERRA HEALTH SERVICES SIE	349.5**	7	3.2	106	0.9	0.5	NM	NM	NM	-10	NA	143	-7.31
TENET HEALTHCARE THC ⁽⁷⁾	3036.0	7	198.0	421	6.5	1.3	8.6	13.9	26	15	-7	13940	1.74
UNITEDHEALTH GROUP UNH	5680.0**	11	212.0	22	3.7	3.4	18.6	20.5	27	2	23	19542	2.32
UNIVERSAL HEALTH SERVICES UHS	676.9**	25	36.2	26	5.3	5.3	8.5	13.6	26	17	18	2562	3.24
WELLPOINT HEALTH NETWORKS WLP	2615.5**	22	96.5	21	3.7	3.7	18.3	20.4	17	4	15	5759	5.53
(D) MEDICAL PRODUCTS													
GROUP COMPOSITE	15492.8	7	2358.9	6	15.2	15.3	20.3	24.0	31	13	12	261350	1.97
BAUSCH & LOMB BOL	412.2	1	-1.3	NM	NM	9.6	4.4	4.1	56	5	-4	2380	0.79
BAXTER INTERNATIONAL BAX	1757.0	11	214.0	12	12.2	12.1	18.3	28.6	37	-2	12	27459	2.53
BECTON, DICKINSON BDV ⁽³⁾	961.2	4	118.4	-1	12.3	12.9	15.4	18.7	22	8	8	8057	1.42
BOSTON SCIENTIFIC BSX	654.0	-4	-5.0	NM	NM	15.6	12.0	13.4	24	20	80	6282	0.65
GUIDANT GDT	671.0**	6	111.2	-6	16.6	18.8	23.8	31.0	32	24	39	11660	1.19
JOHNSON & JOHNSON JNJ	7791.0	6	1500.0	14	19.3	18.0	24.1	26.5	27	15	12	134587	3.52
MEDTRONIC MDT ⁽⁸⁾	1361.6**	8	302.8	17	22.2	20.6	22.6	22.7	44	27	14	53889	1.01
OWENS & MINOR OMI	924.5	8	7.7	13	0.8	0.8	9.7	15.5	19	12	38	614	0.96
ST. JUDE MEDICAL STJ	326.1	10	47.1	197	14.4	5.4	14.7	16.2	32	3	-11	5060	1.84
STRYKER SYK	634.2	13	64.1	24	10.1	9.2	16.4	26.3	50	12	-3	11362	1.16
13 HOUSING & REAL ESTATE													
INDUSTRY COMPOSITE	21047.9	8	645.5	-21	3.1	4.2	7.2	11.0	16	23	15	58801	1.99
(A) BUILDING MATERIALS													
GROUP COMPOSITE	10369.0	-4	46.8	-89	0.5	3.9	6.1	8.6	21	11	7	28438	1.65
AMERICAN STANDARD ASD	1791.0	-2	65.0	8	3.6	3.3	21.8	NM	14	NA	19	4276	4.43
LAFARGE LAF	444.4	2	-66.0	NM	NM	NM	8.5	11.4	12	14	16	2470	2.93
LENNOX INTERNATIONAL LII	716.0	0	-10.2	NM	NM	0.8	5.8	6.1	14	34	NA	619	0.76
MARTIN MARIETTA MATERIALS MLM	300.8	-5	-4.7	NM	NM	2.3	8.3	11.4	22	16	12	2161	2.13
NORTEK NTK	467.3	-5	-2.4	NM	NM	0.8	6.6	12.8	9	21	25	302	3.13
OWENS CORNING OWC	1068.0	-15	-10.0	NM	NM	3.8	NA	NM	NA	NA	NA	125	NA
PPG INDUSTRIES PPG	2099.0	-2	56.0	-60	2.7	6.5	12.7	17.8	17	5	-2	9092	3.11
RPM RPM ⁽⁷⁾	403.7	-2	-7.0	NM	NM	0.9	5.3	7.7	19	15	-6	929	0.47
TECUMSEH PRODUCTS TECUA	404.7	-15	14.0	56	3.5	1.9	7.6	7.3	13	2	-5	908	3.73
USG USG	826.0	-16	11.0	-90	1.3	10.7	NM	-76.3	NM	49	NA	530	-7.55
VALSPAR VAL ⁽²⁾	337.0	4	4.5	-61	1.3	3.5	12.9	18.1	17	16	14	1333	1.84
VULCAN MATERIALS VMC	569.1	11	5.7	-75	1.0	4.5	8.2	13.9	23	13	8	4536	1.99
YORK INTERNATIONAL YRK	942.1	5	-9.0	NM	NM	2.6	10.0	10.6	15	2	2	1157	1.95
(B) CONSTRUCTION & REAL ESTATE													
GROUP COMPOSITE	10678.9	23	598.7	48	5.6	4.7	7.7	12.2	13	33	39	30363	2.27
APARTMENT INVESTMENT & MANAGEMENT AIV	383.4	52	14.0	-46	3.7	10.2	5.1	1.2	NM	65	15	3122	0.27
BEAZER HOMES USA BZH ⁽³⁾	374.3	12	17.5	98	4.7	2.7	13.3	19.5	9	10	35	484	6.69
CENTEX CTX ⁽⁹⁾	2004.8**	15	106.2	52	5.3	4.0	8.6	17.7	9	17	33	2549	4.65
CHAMPION ENTERPRISES CH8	326.3	-39	-26.1	NM	NM	0.2	NM	-64.4	NM	23	NA	421	-3.70
EQUITY OFFICE PROPERTIES TRUST EOP	678.6	41	132.9	28	19.6	21.6	6.5	6.1	18	5	32	8693	1.56

CORPORATE SCOREBOARD

COMPANY SYMBOL	SALES		PROFITS		MARGINS			RETURN			5-YEAR GROWTH			MARKET VALUE SHARES OUTSTANDING \$ MIL.	12 MONTHS' EARNINGS PER SHARE
	1ST QUARTER 2001 \$ MIL.	CHANGE FROM 2000 %	1ST QUARTER 2001 \$ MIL.	CHANGE FROM 2000 %	1ST QUARTER 2001 %	1ST QUARTER 2000 %	ON INVESTED CAPITAL %	ON COMMON EQUITY %	P-E 5-3	COMMON EQUITY %	EARNINGS PER SHARE %				
ORDN (D.R.) OHI ⁽³⁾	906.8	14	51.6	31	5.7	4.9	10.3	19.5	8	59	37	1669	2.75		
DST MARRIDTT HMT	880.0	376	32.0	NM	3.6	NM	NM	18.1	12	11	36	2926	1.02		
B HOME KBH ⁽¹⁾	821.1	3	25.8	-60	3.1	8.0	11.9	24.6	6	14	48	978	4.47		
ENMAR LEN ⁽¹⁾	1104.0**	72	51.3	131	4.6	3.5	11.1	20.2	11	14	15	2716	3.99		
D.C. HOLDINGS MOC	419.4	21	29.3	39	7.0	6.1	16.9	25.2	7	20	50	909	5.47		
VR NVR	531.7**	6	47.9	57	9.0	6.1	35.7	60.6	11	11	79	1519	16.92		
ULTE PHM	832.1	7	39.1	61	4.7	3.1	13.5	18.0	8	10	46	1771	5.52		
FLAND GROUP RYL	514.2	20	16.1	47	3.1	2.5	12.9	18.4	8	8	67	633	6.25		
OLL BROTHERS TOL ⁽²⁾	472.9**	37	39.9	78	8.4	6.5	11.3	20.4	8	24	22	1259	4.30		
EBB (DEL) W88 ⁽⁶⁾	429.2**	-14	21.1	32	4.9	3.2	9.3	17.4	8	16	16	714	4.84		
LEISURE TIME INDUSTRIES															
INDUSTRY COMPOSITE	35191.3	12	921.9	-50	2.6	5.9	4.9	6.3	36	18	6	238662	0.86		
EATING PLACES															
GROUP COMPOSITE	9784.6	3	511.0	-24	5.2	7.1	12.0	21.1	20	5	10	55302	1.39		
INKER INTERNATIONAL EAT ⁽⁶⁾	626.0	14	34.9	22	5.6	5.2	15.0	17.0	20	7	20	2779	1.37		
RL GROUP CBRL ⁽⁵⁾	484.3	9	15.1	136	3.1	1.4	7.1	8.2	16	11	0	1109	1.23		
KE RESTAURANTS CKR ⁽¹¹⁾	354.2	-26	-148.3	NM	NM	NM	NM	-39.0	NM	54	NA	116	-3.85		
ARDEN RESTAURANTS DRJ ⁽⁷⁾	988.6	8	49.5	6	5.0	5.1	13.8	19.1	17	NA	32	3074	1.56		
CDONALD'S MCO	3511.7	5	378.3	-16	10.8	13.5	11.8	20.7	19	4	8	35102	1.43		
UTBACK STEAKHOUSE OSI	521.3	12	37.9	6	7.3	7.7	20.8	17.7	16	26	19	2197	1.83		
DEXHO MARRIDTT SERVICES SDH ⁽⁴⁾	1237.0	5	17.0	21	1.4	1.2	24.0	NM	27	NA	NA	2028	1.16		
ICON GLOBAL RESTAURANTS YUM	1506.0	-6	88.0	-27	5.8	7.5	23.4	NM	16	NA	NA	6033	2.56		
ENDY'S INTERNATIONAL WEN	555.5	7	38.7	8	7.0	6.9	11.1	15.3	17	4	8	2864	1.47		
ENTERTAINMENT															
GROUP COMPOSITE	11480.9	47	140.3	-19	1.2	2.2	0.7	-0.1	NM	30	-5	100724	-0.08		
CKBUSTER 88I	1307.9	8	4.7	NM	0.4	NM	NM	-1.1	NM	NA	NA	3385	-0.38		
ARRAH'S ENTERTAINMENT HET	899.5	15	44.2	44	4.9	3.9	2.6	0.2	NM	19	NA	4108	0.04		
ANDALAY RESDRT GROUP M8G ⁽¹¹⁾ †	598.8**	16	3.4	NM	0.6	NM	7.3	11.2	17	8	-14	1930	1.50		
ETRD-GOLDWYN-MAYER MGM	343.9	0	-17.5	NM	NM	1.5	2.5	1.1	NM	30	NA	4371	0.14		
GM MIRAGE MGG	1069.5	152	84.7	91	7.9	10.4	4.5	8.4	24	22	13	4934	1.28		
ARK PLACE ENTERTAINMENT PPE	1195.0	-1	45.0	-13	3.8	4.3	3.8	3.6	27	NA	28	3506	0.44		
RUMP HOTELS & CASINO RESDRTS OJT	314.1	-1	-16.9	NM	NM	NM	NM	-39.2	NM	3	NA	45	-2.06		
ACDM VIA.8	5752.2	90	-7.3	NM	NM	2.2	-0.5	-0.9	NM	23	NA	78445	-0.40		
HOTEL & MOTEL															
GROUP COMPOSITE	4288.0	8	238.0	16	5.6	5.2	7.6	13.5	20	25	8	22748	1.41		
ILTON HOTELS HLT	833.0	5	55.0	-5	6.6	7.3	6.5	16.4	16	-11	-5	4277	0.72		
MARRIOTT INTERNATIONAL MAR	2441.0	13	121.0	29	5.0	4.3	10.8	15.5	23	28	15	11088	1.99		
TARWOOD HOTELS & RESDRTS HOT	1014.0	2	62.0	17	6.1	5.3	6.8	10.5	19	84	14	7383	2.00		
OTHER LEISURE															
GROUP COMPOSITE	9637.8	-6	32.6	-96	0.3	7.9	10.8	13.7	22	7	7	59888	1.23		
AMERICAN GREETINGS AM ⁽¹⁰⁾	663.2	8	-127.7	NM	NM	8.4	-5.6	-7.9	NM	2	-1	686	-1.46		
RUNSWICK 8C	913.2	-4	39.5	-35	4.3	6.4	11.8	16.5	10	1	-5	1764	2.07		
ARNIVAL CCL ⁽¹⁾	1007.6	22	128.0	-25	12.7	20.8	13.1	15.5	18	21	17	16290	1.54		
ASTMAN KODAK EK	2975.0	-4	150.0	-48	5.0	9.3	29.5	37.0	11	-6	25	13188	4.18		
ETETWOOD ENTERPRISES FLE ⁽⁶⁾	510.2	-40	-205.0	NM	NM	1.9	NM	-65.2	NM	-2	13	385	-6.60		
ARLEY-DAVIDSON HDI	762.3**	-1	92.0	15	12.1	10.4	21.3	24.1	40	23	25	14143	1.17		
ASBRO HAS	463.3	-40	-24.0	NM	NM	2.0	NM	-14.4	NM	-1	NA	2233	-1.04		
MATTEL MAT	731.9	6	-22.0	NM	NM	NM	12.0	13.7	36	4	-20	6816	0.45		
OLARID PRD	330.8	-18	-90.9	NM	NM	NM	NM	-18.3	NM	-14	NA	183	-1.11		
OVAL CARIBBEAN CRUISES RCL	726.9	3	52.5	-50	7.2	14.9	8.4	10.9	10	32	15	3804	2.03		
RANS WORLD ENTERTAINMENT TWMC ⁽¹¹⁾	553.4	7	40.1	-34	7.2	11.7	8.8	9.1	10	32	70	396	0.83		
MANUFACTURING															
INDUSTRY COMPOSITE	58083.2	6	3567.3	-3	6.1	6.7	12.8	18.3	20	13	7	326266	2.36		
GENERAL MANUFACTURING															
GROUP COMPOSITE	18526.8	5	932.6	-17	5.0	6.4	12.5	17.9	23	4	7	93507	2.45		
VERY DENNISON AVY	963.2	0	63.8	-9	6.6	7.3	18.6	32.3	20	0	14	5467	2.80		
LYTH 8TH ⁽¹¹⁾	332.7	-3	11.2	-59	3.4	8.0	14.9	19.1	13	39	41	1013	1.69		
ARLISL CSL	463.2	7	-10.2	NM	NM	5.9	9.9	11.5	19	15	19	1112	1.97		
NERGIZER HOLDINGS ENR ⁽³⁾	351.9	-2	5.6	-64	1.6	4.4	14.1	16.1	19	NA	NA	2129	1.25		
LDWERVE FLS	444.0	56	-8.5	NM	NM	4.2	NM	-2.0	NM	10	-26	1031	-0.13		
ORTUNE BRANDS FO	1217.8	-5	61.5	-4	5.1	5.0	-4.2	-6.6	NM	-10	NA	4751	-0.91		
ARSCD HSC	526.2**	15	10.1	-50	1.9	4.4	8.4	13.2	13	0	3	1103	2.17		
ILLENBRAND INDUSTRIES H8 ⁽¹⁾	525.0	2	25.0	-31	4.8	7.0	13.1	15.7	23	2	10	3199	2.26		
INTERNATIONAL GAME TECHNOLOGY IGT ⁽³⁾	346.9	59	53.6	116	15.4	11.4	20.9	81.9	22	-28	14	4045	2.52		
JOHNSON CONTROLS JCI ⁽³⁾	4601.6	6	83.0	-7	1.8	2.0	15.4	18.2	14	14	20	6105	5.07		
MINNESOTA MINING & MFG. MMM	4170.0	2	453.0	-7	10.9	12.0	24.2	28.2	26	-1	6	46619	4.56		
EWELL RUBBERMAID NWL	1610.7	-1	38.4	-50	2.4	4.7	8.8	16.4	18	16	-10	6892	1.43		
ARKER HANNIFIN PH ⁽⁶⁾	1534.2	10	91.5	-14	6.0	7.7	13.4	16.4	13	13	11	5401	3.56		

CORPORATE SCOREBOARD

COMPANY SYMBOL	SALES		PROFITS		MARGINS		RETURN		5-YEAR GROWTH			MARKET VALUE SHARES OUTSTANDING 5-3 \$ MIL	12 MONTH EARNINGS PER SHARE
	1ST QUARTER 2001 \$ MIL	CHANGE FROM 2000 %	1ST QUARTER 2001 \$ MIL	CHANGE FROM 2000 %	1ST QUARTER 2001 %	1ST QUARTER 2000 %	ON INVESTED CAPITAL %	ON COMMON EQUITY %	P-E 5-3	COMMON EQUITY %	EARNINGS PER SHARE %		
SHAW GROUP SGR ⁽⁴⁾	340.3	97	11.8	68	3.5	4.1	7.3	7.7	51	43	28	2318	1.1
TELEFLEX TFX	470.7	10	30.0	12	6.4	6.3	12.6	15.8	17	14	16	1844	2.9
TOWER AUTOMOTIVE TWR	628.4	-8	12.9	-65	2.0	5.4	NM	-1.1	NM	53	6	478	-0.0
(B) MACHINE & HAND TOOLS													
GROUP COMPOSITE	3791.9	-5	156.3	-16	4.1	4.7	12.9	18.6	13	2	14	9989	2.5
BLACK & DECKER BDK	979.0	-6	33.1	-45	3.4	5.8	20.7	34.4	13	-17	13	3161	3.0
KENAMETAL KMT ⁽⁶⁾	464.7	-4	20.4	45	4.4	2.9	6.5	8.2	16	17	-11	995	2.2
NACCO INDUSTRIES NC	717.2	5	14.4	57	2.0	1.3	6.0	7.1	13	12	-4	560	5.2
SNAP-ON SNA	527.4**	-3	29.4	-17	5.6	6.5	10.8	14.2	14	1	2	1678	2.0
STANLEY WORKS SWK	626.2	-10	46.6	-3	7.4	6.9	21.1	25.4	16	0	24	3059	2.2
TEREX TEX	477.4	-14	12.4	-38	2.6	3.6	12.2	22.8	6	113	40	536	3.4
(C) SPECIAL MACHINERY													
GROUP COMPOSITE	33364.0	9	2448.9	6	7.3	7.5	13.9	19.4	19	21	8	219490	2.5
AGCO AG	532.1	-1	-5.8	NM	NM	NM	NM	1.1	60	5	-54	499	0.1
APPLIED MATERIALS AMAT ⁽²⁾	2731.1	59	558.1	71	20.4	19.0	30.3	30.5	20	29	22	42606	2.6
BRIGGS & STRATTON BGG ⁽⁶⁾	430.2	-8	29.9	-29	6.9	9.0	16.5	16.7	12	-4	12	879	3.2
CATERPILLAR CAT	4810.0	-2	162.0	-37	3.4	5.2	9.8	16.9	18	10	-2	17184	2.7
CRANE CR	379.3	-1	20.3	-27	5.3	7.2	15.4	19.6	15	10	11	1705	1.9
CUMMINS CUM	1349.0	-18	-26.0	NM	NM	2.5	NM	-4.7	NM	2	-39	1606	-1.5
DEERE DE ⁽²⁾	2680.4**	15	56.4	50	2.1	1.6	9.8	11.7	19	6	-12	9370	2.1
DOVER DOV	1247.6	0	79.1	-33	6.3	9.4	16.0	20.1	16	14	12	7724	2.4
FMC FMC	876.6	-13	-20.9	NM	NM	3.3	11.6	15.4	19	2	2	2217	3.8
ILLINOIS TOOL WORKS ITW	2396.8	0	182.8	-17	7.6	9.1	13.9	16.5	21	24	14	19039	3.0
INGERSOLL-RAND IR	2119.6	5	49.3	-64	2.3	6.7	12.5	13.0	16	14	15	7534	2.8
ITT INDUSTRIES ITT	1186.0	-2	59.1	15	5.0	4.2	20.4	22.5	15	14	96	3829	2.8
LAM RESEARCH LRXC ⁽⁶⁾	421.5	29	44.4	-34	10.5	20.5	23.6	30.4	14	3	NA	3340	1.9
McDERMOTT INTERNATIONAL MDR	432.7	-27	-4.4	NM	NM	1.3	NM	-4.4	NM	8	NA	686	-0.5
MILACRON MZ	339.1	-15	3.5	-77	1.0	3.8	11.2	12.6	11	10	-5	633	1.7
NOVELLUS SYSTEMS NVLS	458.7	109	82.1	245	17.9	10.8	16.9	16.9	25	37	8	6896	2.1
PENTAIR PNR	671.4	4	20.6	-39	3.1	5.2	6.3	6.7	22	19	5	1510	1.4
STEWART & STEVENSON SERVICES SSSS ⁽¹¹⁾	338.9	17	10.9	121	3.2	1.7	9.5	9.6	18	-8	-4	626	1.2
TIMKEN TKR	661.5	-4	2.2	-86	0.3	2.3	4.2	3.3	32	4	-18	1031	0.5
TYCO INTERNATIONAL TYC ⁽³⁾	8898.4	26	1155.3	35	13.0	12.1	16.1	24.9	18	67	38	90406	2.9
UNOVA UNA	403.0	-17	-10.0	NM	NM	NM	NM	-7.4	NM	5	NA	170	-0.8
(D) TEXTILES													
GROUP COMPOSITE	2400.6	-4	29.5	-52	1.2	2.5	-6.1	-29.2	NM	2	15	3280	-1.7
BURLINGTON INDUSTRIES BUR ⁽³⁾	361.4	-10	-4.4	NM	NM	0.1	NM	NM	NM	-23	NA	116	-10.3
INTERFACE IFSIA	306.5	5	4.4	NM	1.4	NM	6.6	8.3	13	11	-9	410	0.6
MOHAWK INDUSTRIES MHK	743.7	-3	27.2	-20	3.7	4.4	15.0	20.0	11	24	73	1654	2.9
SPRINGS INDUSTRIES SMI	570.4	-4	13.1	-35	2.3	3.4	7.1	7.3	13	1	-2	803	3.3
WESTPOINT STEVENS WXS	418.6	-7	-10.9	NM	NM	3.5	NM	NM	NM	NA	NA	297	-1.6
16 METALS & MINING													
INDUSTRY COMPOSITE	19595.7	2	477.4	-33	2.4	3.7	5.7	6.5	35	9	-6	59279	0.7
(A) ALUMINUM													
GROUP COMPOSITE	7200.7	26	587.0	60	8.2	6.4	12.5	15.7	20	19	12	35805	1.8
ALCOA AA	6176.0	37	404.0	15	6.5	7.8	12.2	14.0	23	19	14	35391	1.6
KAISER ALUMINUM KLU	480.3	-17	119.6	922	24.9	2.0	18.7	65.9	3	5	-32	318	1.5
MAXXAM MXM	544.4	-15	63.4	NM	11.6	0.5	12.0	184.2	1	NA	7	96	11.8
(B) STEEL													
GROUP COMPOSITE	7433.9	-14	-193.2	NM	NM	2.7	-0.3	-3.0	NM	6	-8	10213	-0.4
AK STEEL HOLDING AKS	998.8	-14	-12.8	NM	NM	2.3	6.7	7.1	16	15	-28	1421	0.8
BETHLEHEM STEEL BS	897.3	-23	-118.4	NM	NM	0.3	NM	-25.4	NM	2	NA	432	-2.1
CARPENTER TECHNOLOGY CRS ⁽⁶⁾	311.8	3	11.6	-3	3.7	3.9	6.9	8.0	11	22	-8	589	2.3
COMMERCIAL METALS CMC ⁽⁴⁾	578.3	-9	1.7	-84	0.3	1.6	6.4	6.1	14	7	5	339	1.6
NATIONAL STEEL NS	589.4	-29	-125.9	NM	NM	1.3	NM	-43.0	NM	8	NA	84	-6.4
NUCOR NUE	1028.0	-14	32.7	-60	3.2	6.8	9.3	12.3	15	10	2	3888	3.2
RYERSON TULL RT	638.1	-19	1.3	-88	0.2	1.4	NM	-5.3	NM	-5	NA	277	-1.4
USX-U.S. STEEL GROUP X	1510.0	-5	9.0	-79	0.6	2.7	NM	-3.3	NM	NA	NA	1676	-0.7
WALTER INDUSTRIES WLT	463.5	0	5.8	-20	1.3	1.6	NM	-63.5	NM	-8	NA	516	-2.6
WORTHINGTON INDUSTRIES WOR ⁽⁷⁾	418.7	-14	1.8	-92	0.4	4.8	5.7	6.6	23	3	-4	991	0.5
(C) OTHER METALS													
GROUP COMPOSITE	4961.1	3	83.6	-27	1.7	2.4	4.1	4.4	52	0	-34	13261	0.4
ENGELHARD EC	1611.3**	36	47.8	18	3.0	4.9	17.1	16.9	21	2	12	3295	1.2
FREEPORT-McMORAN COPPER & GOLD FCX	447.1	-4	47.1	151	10.5	4.0	7.6	NM	30	NA	21	2017	0.4
GENERAL CABLE BGC	562.0	-22	11.5	NM	2.0	NM	NM	4.5	NM	6	NA	409	-0.1

CORPORATE SCOREBOARD

COMPANY SYMBOL	SALES		PROFITS		RETURN				5-YEAR GROWTH			MARKET VALUE SHARES OUTSTANDING 5-3 \$ MIL.	12 MONTHS' EARNINGS PER SHARE
	1ST QUARTER 2001 \$ MIL.	CHANGE FROM 2000 %	1ST QUARTER 2001 \$ MIL.	CHANGE FROM 2000 %	MARGINS		ON INVESTED CAPITAL %	ON COMMON EQUITY %	P-E 5-3	COMMON EQUITY %	EARNINGS PER SHARE %		
					1ST QUARTER 2001 %	1ST QUARTER 2000 %							
EWDMONT MINING NEM	427.5	-7	-37.2	NM	NM	1.7	3.6	-3.9	NM	13	NA	3157	-0.29
LIN OLN	334.2	-12	2.4	-88	0.7	5.1	11.9	20.8	13	-20	-28	810	1.43
HELPS OODGE PD	1100.7	-2	16.2	-16	1.5	1.7	NM	0.9	NM	4	-48	3514	0.33
UPERIOR TELECOM SUT	478.3	-4	-4.2	NM	NM	0.1	NM	-6.5	NM	21	NA	59	-0.34
7 NONBANK FINANCIAL													
INDUSTRY COMPOSITE	184689.7	9	16518.1	-8	8.9	10.6	15.4	16.1	20	18	15	1241211	2.63
8 FINANCIAL SERVICES													
GROUP COMPOSITE	111655.3	10	10528.5	-14	9.4	12.0	17.6	20.1	19	29	21	771277	2.70
AMERICAN EXPRESS AXP	5719.0	1	538.0	-18	9.4	11.6	17.7	22.4	21	7	14	56302	1.99
AMERICAN STEARNS 8SC (1)	2146.1	-20	166.0	-40	7.7	10.3	16.4	12.9	11	20	26	5532	4.55
LOCK (H&R) HR8 (8)	661.4	29	5.6	NM	0.9	NM	24.3	29.7	22	10	22	4840	2.42
CAPITAL ONE FINANCIAL COF	1674.6	43	143.6	35	8.6	9.1	8.7	20.7	27	27	32	12517	2.39
IT GROUP CIT	1588.4	8	160.1	11	10.1	9.8	9.1	10.5	15	28	6	8835	2.40
ITIGROUP C	29804.0	11	3580.0	-7	12.0	14.4	24.0	20.4	20	48	25	256133	2.57
ONCORO EFS CEFT	375.6	24	-26.0	NM	NM	13.7	11.9	12.8	78	57	42	9524	0.56
COUNTRYWIDE CREDIT INDUSTRIES CCR (10)	1132.8**	48	104.2	4	9.2	13.1	6.0	10.5	14	25	28	4998	3.14
UN & BROADSTREET DNB	357.6	0	30.9	14	8.6	7.6	35.6	NM	29	NA	-19	2185	0.93
TRADE GROUP ET (3)	550.1**	-3	-7.2	NM	NM	NM	0.8	2.5	66	166	NA	2924	0.14
DWARDS (A.G.) AGE (10)	656.7	-20	45.9	-54	7.0	12.3	21.1	17.3	12	14	24	3415	3.43
QUIFAX EFX	479.7	6	48.1	14	10.0	9.4	19.2	61.0	19	-4	11	4455	1.71
ANNIE MAE FNM	12365.6	20	1179.8	11	9.5	10.3	8.4	23.7	18	11	16	78724	4.38
DELITY NATIONAL FINANCIAL FNF	777.9	106	45.0	NM	5.8	0.5	10.0	10.7	10	68	30	1598	2.29
RST AMERICAN FAF	781.0**	21	27.0	NM	3.5	0.2	11.5	11.9	12	27	44	1239	1.61
RANKLIN RESOURCES 8EN (3)	577.4**	-6	131.7	-8	22.8	23.4	16.1	17.6	19	22	15	10493	2.31
LOMAN SACHS GROUP GS (1)	9502.0	19	768.0	-13	8.1	11.1	28.7	16.9	17	NA	NA	46193	5.64
ELLER FINANCIAL HF	490.0	5	68.0	-9	13.9	16.1	7.0	11.6	12	12	NA	2943	2.65
HOUSEHOLD INTERNATIONAL HI	3436.6	25	431.8	16	12.6	13.5	NA	23.0	18	26	17	30753	3.68
INDAMERICA FINANCIAL GROUP LFG	438.6	8	6.6	NM	1.5	NM	NM	-16.0	NM	21	NA	429	-6.12
EHMAN BROTHERS HOLDINGS LEH (1)	6752.0	6	387.0	-28	5.7	8.5	41.7	22.2	13	19	46	18044	5.93
MARSH & McLENNAN MMC	2594.0	-3	369.0	9	14.2	12.6	18.3	23.2	23	26	18	26940	4.18
MERRILL LYNCH MER	11950.0	6	874.0	-21	7.3	9.7	24.5	19.7	17	26	23	53632	3.80
ETRIS MXT	397.9	17	56.0	5	14.1	15.7	17.8	30.1	14	37	91	1883	2.14
MORGAN STANLEY DEAN WITTER MWD (1)	12777.0	10	1075.0	-30	8.4	13.3	36.4	26.4	15	35	35	73809	4.33
AYMONO JAMES FINANCIAL RJF (3)	435.0	-5	22.7	-41	5.2	8.4	32.1	16.5	13	20	18	1433	2.42
CHWAB (CHARLES) SCH	1200.0**	-30	97.0	-68	8.1	17.4	26.3	12.2	56	44	31	27685	0.36
FILWELL FINANCIAL SV	448.5	-18	111.4	-41	24.8	34.6	45.9	52.3	13	NA	NA	7027	2.54
FUDENT LOAN STU	309.3	36	22.3	-17	7.2	11.8	17.4	17.3	14	13	12	1399	5.02
OD WATERHOUSE GROUP TWE (2)	347.3**	-9	37.1	-35	10.7	14.9	8.3	8.4	23	NA	NA	4360	0.50
SA EDUCATION SLM	929.2	-7	29.8	-81	3.2	15.4	19.6	26.3	34	3	13	11033	2.00
8 INSURANCE													
GROUP COMPOSITE	63223.5	6	4727.0	1	7.5	7.9	8.2	11.1	23	9	8	410754	2.48
FLAC AFL	2421.0	1	178.0	14	7.4	6.5	9.9	15.1	23	18	16	16183	1.31
LLEGHANY Y	958.9	270	460.5	NM	48.0	NM	36.9	42.4	3	-4	-9	1416	71.68
LLSTATE ALL	7131.0	-2	509.0	-9	7.1	7.7	10.9	12.4	14	7	9	29972	2.90
AMERICAN FINANCIAL GROUP AFG	980.7	11	13.1	-71	1.3	5.0	NM	-5.1	NM	0	NA	1769	-1.37
AMERICAN GENERAL AGC	5829.0**	5	323.0	13	5.5	5.1	10.9	12.1	22	6	12	20571	2.06
AMERICAN INTERNATIONAL GROUP AIG	11253.7**	12	1538.0	14	13.7	13.4	10.2	14.7	33	15	14	192915	2.49
AMERICAN NATIONAL INSURANCE ANAT	453.3	-7	36.8	-41	8.1	12.9	3.6	3.8	17	6	-4	1965	4.32
DN AOC	1811.0	0	19.0	-85	1.0	6.8	8.0	11.0	23	4	11	8441	1.42
ERKLEY (W.R.) 8KLY	449.2	6	10.3	136	2.3	1.0	6.6	6.2	26	-8	-9	1035	1.57
HUBB C8	1891.5	7	175.0	14	9.3	8.7	9.5	10.5	16	5	3	11844	4.11
IGNA CI	4732.0**	-3	276.0	2	5.8	5.5	15.1	18.3	14	-5	29	13650	6.27
INCINNATI FINANCIAL CNF	617.9	8	72.6	-9	11.7	13.9	NM	1.9	56	18	-7	6217	0.69
ONSECO CNC	2136.6	-3	83.8	8	3.9	3.5	NM	-24.0	NM	NA	NA	6448	-3.45
ARTFORD FINANCIAL SERVICES GROUP HIG	3722.0	6	240.0	1	6.4	6.8	9.7	13.1	15	9	10	14118	4.26
EFFERSON-PILOT JP	856.7	4	148.5	7	17.3	16.9	15.3	16.5	13	8	16	6942	3.36
INCOLN NATIONAL LNC	1698.8**	2	164.5	-3	9.7	10.2	11.2	12.4	15	2	14	8822	3.17
DEWS LTR	5104.0	10	472.3	157	9.3	3.9	12.7	19.3	6	6	-6	12968	11.21
MARTEL MKL	332.7	123	8.2	-42	2.5	9.5	NM	-4.5	NM	24	NA	1430	-5.39
MERCURY GENERAL MCY	354.6	7	24.7	-17	7.0	9.0	9.8	10.1	18	13	5	1853	1.93
IGIC INVESTMENT MTG	321.7	23	157.9	24	49.1	48.6	19.6	21.7	12	15	24	6860	5.32
ATIONWIDE FINANCIAL SERVICES NFS	803.5**	1	112.5	7	14.0	13.2	13.3	13.8	12	9	19	5452	3.43
HIO CASUALTY OCAS	447.4	3	-4.1	NM	NM	NM	NM	-0.7	NM	0	NA	556	-0.14
LO REPUBLIC INTERNATIONAL ORI	547.5	11	83.9	52	15.3	11.2	11.4	13.4	11	8	7	3400	2.72
ROGRESSIVE PGR	1773.8	11	86.6	NM	4.9	NM	NM	6.2	50	16	-21	8821	2.42
INSURANCE GROUP OF AMERICA RGA	493.7	23	21.6	-9	4.4	5.9	8.8	12.0	17	19	7	1695	2.07
AFECO SAFC	1739.4	-1	-882.9	NM	NM	1.5	NM	-20.6	NM	3	-21	3456	-6.21
T. PAUL SPC	2354.8	4	208.6	-42	8.9	16.0	9.4	11.9	12	16	-1	9623	3.69
TANCORP FINANCIAL GROUP SFG	384.3	11	26.2	-3	6.8	7.8	9.8	10.1	15	7	NA	1413	2.95

CORPORATE SCOREBOARD

COMPANY SYMBOL	SALES		PROFITS		RETURN				5-YEAR GROWTH				MARKET VALUE SHARES OUTSTANDING 5-3 \$ MIL.	12 MONTH EARN/PER SHAF
	1ST QUARTER 2001 \$ MIL.	CHANGE FROM 2000 %	1ST QUARTER 2001 \$ MIL.	CHANGE FROM 2000 %	MARGINS		ON INVESTED CAPITAL %	ON COMMON EQUITY %	P-E 5-3	COMMON EQUITY %	EARNINGS PER SHARE %			
					1ST QUARTER 2001 %	1ST QUARTER 2000 %								
TORCHMARK TMK	668.2**	8	96.4	8	14.4	14.3	12.9	16.8	13	7	4	4675	2.9	
TRANSATLANTIC HOLOINGS TRH	486.8	5	50.4	-11	10.4	12.2	10.7	10.7	19	13	9	3792	5.8	
UNITRIN UNIT	467.8	-2	16.6	-60	3.5	8.7	3.1	3.9	38	3	3	2452	0.9	
(C) SAVINGS & LOAN														
GROUP COMPOSITE	9810.9	22	1262.6	28	12.9	12.3	NM	14.1	15	22	25	59180	2.6	
ASTORIA FINANCIAL ASFC	395.3**	0	56.7	2	14.3	14.0	NA	13.2	13	23	16	2824	4.3	
CHARTER ONE FINANCIAL CF	693.3**	12	114.8	3	16.6	18.1	NA	17.2	14	28	37	6032	2.0	
OIME BANCORP OME	640.5**	21	92.0	41	14.4	12.4	NA	10.4	22	12	24	3816	1.5	
GOLDEN STATE BANCORP GS8	1117.9**	4	92.8	11	8.3	7.8	NA	15.7	12	NA	NA	3961	2.5	
GOLDEN WEST FINANCIAL GOW	1177.5**	43	176.1	40	15.0	15.2	NA	15.5	16	10	18	9327	3.7	
GREENPOINT FINANCIAL GPT	435.0**	16	78.1	35	17.9	15.4	NA	10.9	15	8	15	3754	2.5	
SOVEREIGN BANCORP SVRN	688.0	40	11.1	-59	1.6	5.5	NA	-2.7	NM	50	NA	2689	-0.2	
WASHINGTON MUTUAL WM	4663.5**	25	641.0	40	13.7	12.3	NA	16.9	13	NA	31	26777	3.8	
18 OFFICE EQUIPMENT & COMPUTERS														
INDUSTRY COMPOSITE	133544.8	15	2648.8	-73	2.0	8.5	8.1	8.8	49	23	26	1632868	0.7	
(A) BUSINESS MACHINES & SERVICES														
GROUP COMPOSITE	11574.5	7	362.3	7	3.1	3.1	13.8	18.4	16	6	23	26625	1.7	
COMPUCOM SYSTEMS CMPC	554.3	-4	1.8	NM	0.3	NM	10.8	7.6	7	11	-31	119	0.3	
OELUXE OLX	315.8	-2	42.5	1	13.5	13.1	56.6	71.8	11	-18	27	1861	2.3	
OIEBOLO OBO	383.9	11	7.6	-76	2.0	9.1	13.3	12.1	20	13	9	2279	1.5	
HON INDUSTRIES HNI	462.0	-4	18.3	-26	4.0	5.1	14.2	17.5	15	23	18	1514	1.6	
MILLER (HERMAN) MLHR (7)	538.4	13	33.0	4	6.1	6.7	40.6	45.8	14	-4	93	2051	1.9	
NCR NCR	1376.0	10	121.0	NM	8.8	NM	NM	16.2	15	6	199	4427	3.0	
PITNEY BOWES P81	966.3	2	103.9	-22	10.8	14.1	14.0	41.2	18	-9	12	9507	2.1	
STANOARD REGISTER SR	297.9	-5	-61.1	NM	NM	NM	NM	-20.9	NM	4	NA	451	-3.2	
STEELCASE SCS (10)	942.4	2	25.7	-42	2.7	4.8	10.9	11.8	10	4	46	1875	1.2	
TECH DATA TECO (11)	5317.0	11	52.7	42	1.0	0.8	15.7	16.3	11	37	37	1831	3.1	
WALLACE COMPUTER SERVICES WCS (5)	420.5	9	16.9	65	4.0	2.7	4.4	4.8	26	4	-10	710	0.6	
(B) COMPUTERS & PERIPHERALS														
GROUP COMPOSITE	70468.7	5	2841.3	-32	4.0	6.2	17.1	19.7	33	10	16	542400	1.0	
APPLE COMPUTER AAPL (3)	1431.0	-26	43.0	-82	3.0	12.0	4.9	5.5	47	9	6	8650	0.5	
COMPAQ COMPUTER CPQ	9197.0	-3	78.0	-76	0.8	3.4	4.3	2.9	87	24	-17	29354	0.2	
OELL COMPUTER OELL (11)	8674.0	28	434.0	0	5.0	6.4	36.5	39.8	31	47	73	64569	0.8	
EMC EMC	2344.8	29	398.8	20	17.0	18.2	21.9	22.1	49	47	37	88061	0.8	
GATEWAY GTW	2033.5	-15	-479.1	NM	NM	5.5	NM	-19.2	NM	34	14	5947	-1.1	
HEWLETT-PACKARD HWP (2)	11948.0	2	305.0	-62	2.6	6.8	19.2	21.7	18	6	8	53569	1.5	
INTERNATIONAL BUSINESS MACHINES IBM	21044.0	9	1750.0	15	8.3	7.9	21.8	40.8	25	-2	20	198168	4.6	
LEXMARK INTERNATIONAL LXX	999.4	12	79.7	-1	8.0	9.0	28.8	32.6	32	13	47	8807	2.1	
MAXTOR MXO	630.8	-9	1.3	-95	0.2	4.0	4.7	1.8	NM	NA	NA	928	0.0	
PALM PALM (7)	470.8	73	-1.9	NM	NM	4.0	4.3	4.3	92	NA	NA	4668	0.0	
QUANTUM OLT & STORAGE SYSTEMS OSS (9)	308.6	-16	31.7	42	10.3	6.1	20.8	24.9	11	NA	NA	1769	1.0	
SILICON GRAPHICS SGI (6)	509.7	-10	-141.1	NM	NM	NM	NM	NM	NM	-13	NA	534	-4.6	
STORAGE TECHNOLOGY STK	468.8	2	-3.0	NM	NM	NM	4.5	3.7	42	-3	NA	1463	0.3	
SUN MICROSYSTEMS SUNW (6)	4095.0	2	136.0	-73	3.3	12.7	20.1	16.9	38	28	36	64545	0.5	
UNISYS UIS	1623.8	6	69.3	-35	4.3	7.0	9.1	9.1	19	57	NA	3811	0.6	
WESTERN DIGITAL WDC (6)	533.4	3	-3.4	NM	NM	NM	NM	NM	NM	NA	NA	940	-0.1	
XEROX XRX	4156.0	-8	143.0	NM	3.4	NM	NA	-0.8	NM	5	3	6617	-0.0	
(C) COMPUTER SOFTWARE & SERVICES														
GROUP COMPOSITE	51501.6	37	-554.8	NM	NM	14.2	5.0	5.3	69	42	35	1063843	0.5	
AODBE SYSTEMS AODBE (1)	329.0	17	69.8	8	21.2	22.9	39.2	39.4	35	-3	27	9717	1.1	
AFFILIATED COMPUTER SERVICES ACS (6)	533.6	5	35.2	26	6.6	5.5	9.2	15.4	30	41	27	3597	2.3	
AMERICAN MANAGEMENT SYSTEMS AMSY	323.0	4	5.5	-64	1.7	4.9	8.4	9.4	26	16	20	880	0.8	
AOL TIME WARNER AOL	9080.0	NA	-1369.0	NA	NM	NA	NA	NA	NA	NA	NA	216387	N	
AUTOMATIC DATA PROCESSING AOP (6)	1894.3**	10	288.9	6	15.3	15.8	16.8	17.6	38	18	14	33331	1.3	
BMC SOFTWARE BMC (9)	422.8	-11	23.0	-77	5.4	20.6	2.8	2.3	NM	44	27	5908	0.1	
CAODENCE DESIGN SYSTEMS CON	344.7	34	3.8	NM	1.1	NM	7.2	6.7	88	42	-14	5117	0.2	
CERIOIAN CEN	309.6	0	17.9	175	5.8	2.1	7.0	7.1	29	41	2	2624	0.6	
CISCO SYSTEMS CSCO (5)	6748.0	55	874.0	7	13.0	18.7	10.5	10.5	44	75	34	135117	0.4	
CMGI CMGI (5)	342.7	116	-2561.5	NM	NM	NM	NM	NM	NM	161	NA	1974	-14.0	
COMOISCO COO (3)	940.0	-6	-8.0	NM	NM	7.1	10.9	24.0	2	13	10	432	1.3	
COMPUWARE CPWR (9)	514.5	-12	46.6	0	9.1	8.0	8.6	8.6	31	35	30	3596	0.3	
DST SYSTEMS DST	371.0	9	54.5	-3	14.7	16.5	10.3	13.7	29	28	25	5961	1.6	
ELECTRONIC DATA SYSTEMS EOS	4987.3	9	470.0	63	9.4	6.3	17.3	25.1	23	0	3	29919	2.7	
EXODUS COMMUNICATIONS EXOS	348.7	163	-649.6	NM	NM	NM	NM	-39.6	NM	NA	NA	4292	1.6	
FIRST DATA FOC	1471.2**	10	190.2	15	12.9	12.3	21.8	25.6	28	3	26	25936	2.3	
FISERV FISV	453.9	15	50.8	18	11.2	10.9	11.4	14.0	36	25	24	6448	1.4	
GALILEO INTERNATIONAL GLC	465.8	6	50.6	7	10.9	10.8	19.0	31.0	15	-17	3	2275	1.6	
GENUITY GENU	299.5	21	-292.4	NM	NM	NM	NM	29.7	NM	NA	NA	457	5.3	

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COMPANY SYMBOL	SALES		PROFITS		MARGINS		RETURN			5-YEAR GROWTH			MARKET VALUE SHARES OUTSTANDING \$ MIL.	12-MONTH EARN- PER SHA
	1ST QUARTER 2001 \$ MIL.	CHANGE FROM 2000 %	1ST QUARTER 2001 \$ MIL.	CHANGE FROM 2000 %	1ST QUARTER 2001 %	1ST QUARTER 2000 %	ON INVESTED CAPITAL %	ON COMMON EQUITY %	P-E 5-3	COMMON EQUITY %	EARNINGS PER SHARE %			
12 TECHNOLOGIES ITWO	356.6	91	-774.1	NM	NM	6.3	NM	-30.0	NM	217	NA	9127	-6.7	
IMATION IMN	299.9	-9	4.9	-76	1.6	6.1	NM	-2.5	NM	-6	NA	828	-0.4	
INGRAM MICRO IM	7193.5	-8	26.4	-72	0.4	1.2	8.9	8.3	14	40	16	2155	1.0	
INTUIT INTU (5)	457.6	8	26.6	-54	5.8	13.5	14.1	13.2	22	57	NA	6447	1.3	
JUNIPER NETWORKS JNPR	332.1	420	58.6	626	17.6	12.6	11.7	23.9	NM	218	NA	19346	0.2	
MICROSOFT MSFT (6)	6456.0	14	2451.0	3	38.0	42.2	20.2	20.9	38	53	46	364648	1.3	
ORACLE ORCL (7)	2674.4	9	582.7	-24	21.8	31.2	111.2	124.3	15	36	58	92284	1.1	
PEOPLESFT PSFT	503.1	34	36.1	115	7.2	4.5	14.4	15.2	68	46	37	10608	0.9	
SABRE HOLDINGS TSG	573.4**	20	0.4	-99	0.1	10.3	4.3	10.0	69	12	0	6507	0.7	
SIEBEL SYSTEMS SE8L	588.7	84	76.9	118	13.1	11.0	15.7	16.7	94	147	195	20784	0.4	
SOFTWARE SPECTRUM SSPE (8)	429.1	42	3.7	-9	0.9	1.4	4.2	3.4	17	1	-6	39	0.6	
SUNGARO DATA SYSTEMS SDS	440.8	15	54.0	30	12.2	10.8	15.0	15.0	35	31	19	7612	1.6	
3COM COMS (7)	629.6	-45	-246.0	NM	NM	42.9	NM	-8.8	NM	53	2	2196	-1.7	
VERITAS SOFTWARE VRTS	387.4	58	-156.1	NM	NM	NM	NM	-20.6	NM	185	NA	27294	-1.5	
19 PAPER & FOREST PRODUCTS														
INDUSTRY COMPOSITE	25519.2	3	365.2	-73	1.4	5.6	5.6	8.0	26	4	1	81629	1.7	
(A) FOREST PRODUCTS														
GROUP COMPOSITE	6881.5	8	-225.4	NM	NM	4.0	0.1	-2.2	NM	-27	-5	7719	-0.4	
GEORGIA-PACIFIC GROUP GP	6323.0	14	-136.0	NM	NM	3.5	0.9	0.2	NM	NA	-5	6393	0.2	
LOUISIANA-PACIFIC LPX	558.5	-33	-89.4	NM	NM	7.0	NM	-13.5	NM	-4	NA	1326	-1.5	
(B) PAPER														
GROUP COMPOSITE	18637.7	1	590.6	-47	3.2	6.1	7.5	10.1	23	8	2	73910	2.1	
BOISE CASCADE BCC	1901.3	-5	-35.5	NM	NM	2.0	5.0	5.5	24	4	NA	1990	1.4	
BOWATER BOW	604.9	7	37.7	119	6.2	3.1	7.9	10.0	14	15	-16	2409	3.4	
INTERNATIONAL PAPER IP	6894.0	8	18.0	-93	0.3	3.8	4.0	1.2	NM	7	-28	18297	0.2	
KIMBERLY-CLARK KMB	3608.4	7	433.4	-8	12.0	13.9	22.0	30.6	18	8	82	30908	3.2	
MEAO MEA	944.5	-1	-36.6	NM	NM	2.4	4.1	4.3	27	2	-8	2711	1.0	
WEYERHAEUSER WY	3553.0	-9	107.0	-56	3.0	6.2	7.2	10.3	18	10	1	12280	3.1	
WILLAMETTE INDUSTRIES WLL	1131.7	-3	66.6	-22	5.9	7.3	9.1	13.4	16	5	-3	5315	2.9	
20 PUBLISHING & BROADCASTING														
INDUSTRY COMPOSITE	20525.0	13	-812.1	NM	NM	7.6	1.6	2.3	NM	29	11	235930	0.3	
(A) BROADCASTING														
GROUP COMPOSITE	11676.7	14	-1347.9	NM	NM	7.2	-0.4	-0.9	NM	44	12	155018	-0.1	
CHARTER COMMUNICATIONS CHTR	873.8	21	-256.8	NM	NM	NM	NM	-31.7	NM	NA	NA	5084	-3.9	
CLEAR CHANNEL COMMUNICATIONS CCU	1628.4	108	-309.2	NM	NM	NM	0.0	-0.1	NM	180	14	32094	0.1	
COX COMMUNICATIONS COX	947.9	22	-30.5	NM	NM	NM	5.1	8.7	32	43	72	26250	1.3	
DISNEY (WALT) DIS (3)	6049.0	-4	-567.0	NM	NM	1.2	1.2	0.9	NM	23	-10	65140	0.0	
ECHOSTAR COMMUNICATIONS DISH	861.9	52	-167.0	NM	NM	NM	NM	NM	NM	NA	NA	17512	-1.2	
USA NETWORKS USAI	1315.7	26	-17.4	NM	NM	NM	-0.4	-2.5	NM	155	NA	8938	-0.2	
(B) PUBLISHING														
GROUP COMPOSITE	8848.3	10	535.9	-19	6.1	8.2	7.7	12.6	31	9	13	80912	1.5	
BELO BLC	331.5	-9	0.6	-96	0.2	4.2	6.0	10.2	16	34	9	2015	1.1	
OOW JONES DJ	459.9	-17	6.2	-93	1.3	16.1	NM	NM	NM	-35	NA	4720	-2.2	
GANNETT GCI	1574.9	19	174.5	-14	11.1	15.4	10.0	18.5	18	18	16	17331	3.5	
HARCOURT GENERAL H (2)	407.1	1	-48.6	NM	NM	NM	12.0	23.4	24	-7	-3	4030	2.3	
KNIGHT-RIDDER KRI	735.4	-3	40.7	-75	5.5	21.2	8.2	11.9	24	9	17	4022	2.2	
McGRAW-HILL MHP	846.4	8	20.4	-53	2.4	5.5	17.2	25.7	29	10	11	12720	2.2	
NEW YORK TIMES NYT	778.2	-5	60.1	-25	7.7	9.8	20.4	29.2	19	-4	35	6737	2.2	
PRIMEDIA PRM	427.0	6	-85.8	NM	NM	NM	NM	NM	NM	NA	NA	1652	-2.6	
READER'S DIGEST ASSOCIATION RDA (6)	607.7	-2	27.9	118	4.6	2.1	34.6	37.0	16	-6	-7	2833	1.6	
SCHOLASTIC SCHL (7)	433.0	37	3.7	85	0.9	0.6	9.2	16.5	19	10	18	1487	2.2	
SCRIPPS (E.W.) SSP	367.4	-11	66.4	98	18.1	8.2	12.2	15.4	26	3	10	5046	2.4	
TRIBUNE TR8	1292.8	79	70.6	3	5.5	9.4	4.0	5.1	46	33	20	12810	0.9	
WASHINGTON POST WPO	587.0	7	199.1	727	33.9	4.4	13.9	21.0	18	4	0	5509	32.7	
21 SERVICE INDUSTRIES														
INDUSTRY COMPOSITE	56252.2	6	798.8	-42	1.4	2.6	9.1	11.3	27	21	8	139296	0.9	
(A) CONSTRUCTION & ENGINEERING														
GROUP COMPOSITE	6793.6	2	140.4	-14	2.1	2.4	7.6	11.3	23	21	-3	12514	1.1	
EMCOR GROUP EME	837.6	13	5.7	15	0.7	0.7	12.9	16.9	12	27	48	328	2.9	
FLUOR FLR (2)	2022.8	-12	11.2	-69	0.6	1.6	3.9	7.9	NA	1	-15	3863	NM	
FOSTER WHEELER FWC	682.6	-17	8.1	-3	1.2	1.0	7.3	10.8	16	-12	NA	624	0.9	
JACOBS ENGINEERING GROUP JEC (3)	1009.9	15	21.6	19	2.1	2.1	13.6	14.8	22	16	11	1710	2.9	
MASTEC MTZ	337.2	24	3.3	-71	1.0	4.2	9.1	11.3	13	49	9	705	1.1	
QUANTA SERVICES PWR	519.0	56	29.3	50	5.6	5.9	8.4	10.1	19	313	74	1627	1.5	
REPUBLIC SERVICES RSG	535.4	7	49.6	-1	9.3	10.0	9.0	13.2	15	NA	21	3170	1.2	
IT GROUP ITX	333.5	5	2.2	-55	0.7	1.5	NM	2.7	NM	15	NA	101	-0.7	
URS URS (2)	515.6	1	9.5	10	1.8	1.7	8.8	15.8	10	49	33	386	2.2	

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COMPANY SYMBOL	SALES		PROFITS		MARGINS		RETURN			5-YEAR GROWTH			MARKET VALUE SHARES OUTSTANDING 5-3 \$ MIL.	12 MONTH EARN PER SHAR
	1ST QUARTER 2001 \$ MIL.	CHANGE FROM 2000 %	1ST QUARTER 2001 \$ MIL.	CHANGE FROM 2000 %	1ST QUARTER 2001 %	1ST QUARTER 2000 %	ON INVESTED CAPITAL %	ON COMMON EQUITY %	P-E 5-3	COMMON EQUITY %	EARNINGS PER SHARE			
(B) INDUSTRIAL DISTRIBUTION														
GROUP COMPOSITE	16876.1	7	-226.6	NM	NM	2.0	4.4	5.2	35	10	6	17891	0.5	
APPLIED INDUSTRIAL TECHNOLOGIES AIT ⁽⁶⁾	408.8	-3	7.0	-16	1.7	2.0	9.0	10.5	12	14	4	378	1.6	
ARROW ELECTRONICS ARW	3275.7	18	71.7	14	2.2	2.3	9.9	19.0	8	8	4	2710	3.6	
AUDIOVOX VOXX ⁽¹⁾	330.7	-3	2.6	-52	0.8	1.6	7.4	6.8	9	22	28	187	0.9	
AVNET AVT ⁽⁶⁾	3208.6	19	57.8	40	1.8	1.5	9.5	12.2	9	5	2	2345	2.9	
BELL MICROPRODUCTS BELM	535.5	46	0.1	-96	0.0	0.9	10.8	11.0	11	14	22	147	0.8	
BRIGHTPOINT CELL	465.3	-3	1.4	-78	0.3	1.4	8.6	13.3	9	25	21	227	0.4	
CELLSTAR CLST ⁽¹⁾	645.2	9	4.2	-56	0.7	1.6	NM	-33.6	NM	17	NA	76	-1.0	
FISHER SCIENTIFIC INTERNATIONAL FSH	687.0	5	-23.7	NM	NM	1.3	NM	NM	NM	NA	54	1023	-0.2	
GENUINE PARTS GPC	2055.0	-1	89.3	-3	4.3	4.4	13.1	16.8	12	7	5	4611	2.2	
GRAINGER (W.W.) GWW	1219.4	0	42.2	2	3.5	3.4	12.5	12.6	19	4	2	3663	2.0	
HUGHES SUPPLY HUG ⁽¹¹⁾	741.7	3	-9.1	NM	NM	1.6	6.5	8.2	8	28	7	369	1.9	
METALS USA MUI	436.0	-17	-10.2	NM	NM	2.1	NM	-2.7	NM	562	3	99	-0.2	
RELIANCE STEEL & ALUMINUM RS	432.9	0	12.8	-21	2.9	3.7	8.3	14.2	13	21	18	730	2.2	
U.S. OFFICE PRODUCTS OFIS ⁽⁸⁾	446.3	-29	-497.7	NM	NM	NM	NM	NM	NM	42	NA	0	-24.8	
UNITED STATIONERS USTR	1059.8	7	21.6	-10	2.0	2.4	13.0	19.5	10	74	71	966	2.7	
WESCO INTERNATIONAL WCC	928.1	0	3.5	-62	0.4	1.0	8.4	22.2	14	NA	NA	360	0.5	
(C) PRINTING & ADVERTISING														
GROUP COMPOSITE	4934.8	6	86.7	-65	1.8	5.4	13.8	19.3	30	7	20	32603	1.5	
BANTA BN	372.8	9	2.6	-73	0.7	2.9	10.8	13.9	11	-2	-4	629	2.3	
DONNELLEY (R.R.) DNY	1302.7	-3	14.5	-69	1.1	3.5	13.0	19.0	15	-11	5	3373	1.9	
INTERPUBLIC GROUP IPG	1302.2	6	-38.4	NM	NM	3.5	10.7	13.8	38	22	15	10699	0.8	
OMNICOM GROUP OMC	1601.1	16	98.2	-32	6.1	10.4	18.3	29.3	35	23	24	15982	2.5	
TRUE NORTH COMMUNICATIONS TNO	356.1	-1	9.7	38	2.7	1.9	17.5	15.1	30	13	1	1920	1.2	
(D) OTHER SERVICES														
GROUP COMPOSITE	27647.6	6	798.3	25	2.9	2.4	10.7	12.0	25	37	10	76288	0.8	
ABM INDUSTRIES ABM ⁽²⁾	470.4**	10	8.4	12	1.8	1.8	12.8	13.6	17	18	17	746	1.8	
ADMINISTAFF ASF	1043.4	38	-4.3	NM	NM	NM	13.4	15.7	51	63	57	695	0.5	
AUTONATION AN	4887.0	-7	59.9	-7	1.2	1.2	9.1	8.4	11	54	38	3286	0.9	
CARMAX GROUP KMX ⁽¹⁰⁾	640.0	27	7.8	NM	1.2	NM	11.1	11.6	25	NA	NA	274	0.4	
CASEY'S GENERAL STORES CASY ⁽⁸⁾	437.8*	9	4.0	-24	0.9	1.3	8.2	11.9	15	12	13	594	0.8	
COI CDI	405.2	-4	3.7	-68	0.9	2.8	7.4	7.6	11	18	3	279	1.3	
CENOANT CD	1303.0	38	254.0	129	19.5	11.7	12.1	13.6	19	28	6	12919	0.9	
CINTAS CTAS ⁽⁷⁾	536.7	13	54.9	12	10.2	10.4	15.0	17.8	36	24	20	7706	1.2	
CONVERGYS CVG	577.8	13	53.5	20	9.3	8.6	15.7	17.3	29	NA	22	5842	1.2	
GROUP 1 AUTOMOTIVE GPI	928.9	8	9.3	3	1.0	1.0	18.9	16.3	9	43	65	364	1.9	
HANOLEMAN HDL ^{(8)S}	349.0	2	16.3	11	4.7	4.3	15.0	16.9	8	-6	-2	325	1.5	
IMS HEALTH RX	329.6	-6	65.8	-21	20.0	23.5	36.8	95.7	82	-38	7	8158	0.3	
KELLY SERVICES KELYA	1087.2	1	4.8	-70	0.4	1.5	12.4	12.4	11	5	6	829	2.1	
KPMG CONSULTING KCM ⁽⁶⁾	750.9	19	29.5	NM	3.9	NM	7.0	-24.3	NM	NA	NA	2441	-1.5	
LITHIA MOTORS LAD	420.2	6	2.9	-42	0.7	1.3	12.1	12.8	12	156	25	231	1.6	
MANPOWER MAN	2651.9	3	26.8	5	1.0	1.0	16.0	23.8	14	8	2	2391	2.2	
MOIS PROFESSIONAL SERVICES MPS	444.4	-3	6.4	-51	1.4	2.8	NM	9.1	4	51	23	486	1.1	
NOVA NIS	370.1	0	18.2	-3	4.9	5.1	1.6	-4.8	NM	50	NA	1498	-0.2	
PANTRY PTRY ⁽³⁾	635.7*	9	-4.9	NM	NM	NM	6.2	9.4	13	NA	NA	136	0.5	
PAYCHEX PAYX ⁽⁷⁾	467.3	21	66.4	34	14.2	12.9	33.3	33.3	49	32	35	11737	0.6	
QUINTILES TRANSNATIONAL QTRN	404.5	-3	7.8	NM	1.9	NM	0.8	0.8	NM	62	NA	2301	0.0	
REGIS RGIS ⁽⁶⁾	330.9	15	12.5	8	3.8	4.0	11.0	16.2	15	30	17	780	1.2	
RENT-A-CENTER RCI	439.7	12	25.0	20	5.7	5.3	10.9	31.2	13	23	45	955	3.0	
ROBERT HALF INTERNATIONAL RHI	719.3	14	47.6	10	6.6	6.9	26.3	26.5	27	25	35	4924	1.0	
SERVICEMASTER SVM	1329.7	-1	23.2	-36	1.7	2.7	7.9	14.9	19	30	-3	3229	0.5	
SONIC AUTOMOTIVE SAH	1540.2	5	13.5	-22	0.9	1.2	13.2	15.6	6	105	76	432	1.6	
SPHERION SFN	854.6	-11	-22.8	NM	NM	2.6	6.3	2.3	17	43	13	482	0.4	
STAFF LEASING STFF	752.3	3	0.1	NM	0.0	NM	NM	1.6	58	12	-68	72	0.0	
UNITED AUTO GROUP UAG	1395.0	26	6.6	16	0.5	0.5	8.6	6.6	13	43	21	327	1.1	
UNITED RENTALS URI	619.1	7	3.4	-80	0.6	3.0	6.7	10.5	13	112	NA	1579	1.7	
VOLT INFORMATION SCIENCES VOL ⁽²⁾	525.9	5	-1.9	NM	NM	0.7	10.0	9.6	11	20	9	270	1.6	
22 TELECOMMUNICATIONS														
INDUSTRY COMPOSITE	92188.9	17	-254.1	NM	NM	9.8	3.9	5.7	37	40	23	791823	0.7	
(A) EQUIPMENT & SERVICES														
GROUP COMPOSITE	51386.7	29	-5124.4	NM	NM	7.0	-0.4	-1.0	NM	44	42	333750	-0.1	
AOC TELECOMMUNICATIONS ADCT ⁽²⁾	804.8	36	2.2	-96	0.3	8.9	31.4	31.6	7	37	39	5965	1.0	
ARCH WIRELESS ARCH	327.4	72	-194.2	NM	NM	NM	NM	NM	NM	NA	NA	73	4.7	
AT&T	16763.0	5	-1562.0	NM	NM	10.9	-0.1	0.2	NM	46	45	74792	-0.1	
AT&T WIRELESS GROUP AWE	3212.0	46	0.0	NM	0.0	1.2	NA	NA	81	NA	NA	7033	0.2	
CENTURYTEL CTL	516.0	25	46.7	-5	9.1	11.9	6.7	11.3	17	19	15	3937	1.6	
CIENA CIEN ⁽²⁾	352.0	131	53.2	488	15.1	6.0	13.1	13.6	NM	188	24	15748	0.4	

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COMPANY SYMBOL	SALES		PROFITS		MARGINS		RETURN		5-YEAR GROWTH			MARKET VALUE SHARES OUTSTANDING 5-3 \$ MIL	12-MONTH EARN PER SHARE
	1ST QUARTER 2001 \$ MIL	CHANGE FROM 2000 %	1ST QUARTER 2001 \$ MIL	CHANGE FROM 2000 %	1ST QUARTER 2001 %	1ST QUARTER 2000 %	ON INVESTED CAPITAL %	ON COMMON EQUITY %	P-E 5-3	COMMON EQUITY %	EARNINGS PER SHARE %		
COMVERSE TECHNOLOGY CMVT ⁽¹¹⁾	346.6	37	76.9	48	22.2	20.6	NA	20.2	46	56	44	11306	1.4
CORNING GLW	1921.0**	42	132.0	71	6.9	5.7	NA	4.3	45	37	0	21162	0.8
LEVEL 3 COMMUNICATIONS LVL	449.0	154	-535.0	NM	NM	NM	NM	-42.4	NM	22	NA	6087	-4.0
LUCENT TECHNOLOGIES LU ⁽³⁾	5915.0	NA	-3380.0	NA	NM	NA	NM	-22.8	NM	76	67	36396	-1.4
McLEODUSA MCLD	433.0	50	-173.2	NM	NM	NM	NM	-22.6	NM	129	NA	4107	-1.0
NEXTEL COMMUNICATIONS NXTL	1742.0	48	-372.0	NM	NM	NM	NM	-58.3	NM	-6	NA	14230	-1.3
SCIENTIFIC-ATLANTA SFA ⁽⁶⁾	663.7	51	76.2	100	11.5	8.6	23.2	23.3	30	20	43	9360	1.9
SPRINT FON GROUP FON	4358.0	-1	316.0	-29	7.3	10.1	6.7	9.3	17	NA	6	19390	1.3
SPRINT PCS GROUP PCS	2051.0	68	-393.0	NM	NM	NM	NM	NM	NA	NA	NA	24346	-1.8
TELEPHONE & DATA SYSTEMS TDS	600.4	12	31.2	-12	5.2	6.6	3.5	3.8	44	15	11	6074	2.3
TELLABS TLAB	772.1	22	122.5	2	15.9	19.1	27.7	27.7	21	46	48	16024	1.8
U.S. CELLULAR USM	439.8	12	34.0	-27	7.7	11.9	8.2	10.1	24	12	23	5542	2.6
WORLDCOM WCOM	9720.0	1	594.0	-53	6.1	13.2	5.5	6.3	15	85	36	52178	1.7
(B) TELEPHONE COMPANIES													
GROUP COMPOSITE	40802.2	5	4870.2	-2	11.9	12.7	10.4	18.7	19	34	16	458073	2.4
ALLTEL AT	1797.9	9	376.2	74	20.9	13.1	25.0	39.6	8	23	23	17384	6.1
BELLSOUTH BLS	5919.0	-8	891.0	-11	15.1	15.5	14.7	23.6	19	6	19	78497	2.1
BROADWING BRW	578.3	26	-34.0	NM	NM	NM	NM	-19.3	NM	29	NA	5535	-1.1
QWEST COMMUNICATIONS INTL. Q	5051.0	50	19.0	-95	0.4	12.0	NM	-1.1	NM	NA	NA	64297	-0.8
SBC COMMUNICATIONS SBC	11190.0	-11	1864.0	2	16.7	14.5	16.6	26.3	18	42	10	141564	2.3
VERIZON COMMUNICATIONS VZ	16266.0	12	1754.0	12	10.8	10.8	11.7	31.7	14	35	13	150796	3.5
23 TRANSPORTATION													
INDUSTRY COMPOSITE	55919.9	2	260.6	-86	0.5	3.5	5.4	9.6	24	14	6	167502	1.5
(A) AIRLINES													
GROUP COMPOSITE	23208.6	3	-747.3	NM	NM	1.9	4.3	7.4	22	29	15	35704	1.7
ALASKA AIR GROUP ALK	516.0	5	-33.1	NM	NM	NM	NM	-4.5	NM	38	NA	751	-1.1
AMERICA WEST HOLDINGS AWA	587.5	4	-12.8	NM	NM	2.6	-1.8	-3.0	NM	2	0	356	-0.1
AMR AMR	4760.0	4	-43.0	NM	NM	1.9	6.0	8.9	10	12	20	5917	3.1
AMTRAN AMTR	347.5	8	-4.4	NM	NM	NM	NM	-15.5	NM	18	NA	117	-1.1
CONTINENTAL AIRLINES CAL	2451.0	8	11.0	-21	0.4	0.6	8.3	29.6	9	33	10	2979	5.1
DELTA AIR LINES DAL	3842.0	-2	-133.0	NM	NM	5.5	6.6	10.6	10	23	48	5523	4.1
NORTHWEST AIRLINES NWAC	2611.0	4	-171.0	NM	NM	0.1	4.4	35.1	36	NM	-7	2082	0.1
SOUTHWEST AIRLINES LUV	1428.6	15	121.0	27	8.5	7.7	13.1	17.9	23	19	29	14066	0.1
UAL UAL	4424.0	-3	-304.0	NM	NM	2.4	NM	-3.8	NM	42	7	1950	-4.1
US AIRWAYS GROUP U	2241.0	7	-178.0	NM	NM	NM	NM	NM	NM	NA	NA	1963	-3.1
(B) RAILROADS													
GROUP COMPOSITE	8800.0	1	402.0	-2	4.6	4.7	4.8	7.7	19	6	-6	39648	1.7
BURLINGTON NORTHERN SANTA FE BNI	2292.0	1	140.0	-42	6.1	10.7	5.6	11.5	14	9	27	11434	2.1
CSX CSX	2025.0	0	20.0	-31	1.0	1.4	3.8	3.0	40	6	-34	7335	0.1
NORFOLK SOUTHERN NSC	1540.0	2	61.0	NM	4.0	NM	4.1	4.8	26	5	-26	7301	0.1
UNION PACIFIC UNP	2943.0	1	181.0	-2	6.2	6.4	5.0	9.5	17	4	3	13578	3.1
(C) TRANSPORTATION SERVICES													
GROUP COMPOSITE	11863.6	3	6.8	-97	0.1	1.7	1.8	3.0	73	15	11	20685	0.1
AIRBORNE ABF	823.5	1	-17.0	NM	NM	2.2	NM	1.6	NM	19	0	468	-0.1
ANC RENTAL ANCX	769.1	-5	-40.1	NM	NM	NM	NM	-2.0	NM	NA	NA	159	-0.1
BUDGET GROUP BD	529.5**	-6	-95.1	NM	NM	NM	NM	NM	NM	NA	NA	130	-17.1
CNF CNF	1278.5	-3	15.6	-59	1.2	2.9	8.1	11.2	14	12	24	1518	2.1
FEDEX FOX ⁽⁷⁾	4838.8	7	108.7	-4	2.2	2.5	10.4	12.4	17	18	13	11806	2.1
GATX GMT	356.0	23	4.4	-88	1.2	13.0	0.0	-0.3	NM	2	-13	1872	-0.1
HUB GROUP HUBG	345.9	5	-0.7	NM	NM	NM	3.8	3.2	18	26	16	75	0.1
PITTSBURGH PZB	908.3	-2	8.7	-40	1.0	1.6	1.8	-0.4	NM	NA	38	1094	0.1
ROBINSON (C.H.) WORLDWIDE CHRW	732.5	13	18.1	19	2.5	2.3	24.9	23.9	32	17	24	2347	0.1
RYDER SYSTEM R	1281.5	-2	4.1	-79	0.3	1.5	4.3	5.9	16	1	-9	1216	1.1
(D) TRUCKING & SHIPPING													
GROUP COMPOSITE	12047.7	1	599.0	-33	5.0	7.6	16.3	23.4	24	16	7	71465	2.1
ARKANSAS BEST ABFS	400.6	-10	9.1	-31	2.3	3.0	16.5	23.3	7	12	65	402	2.1
CONSOLIDATED FREIGHTWAYS CFWY	574.6	-3	-1.8	NM	NM	NM	NM	-2.6	NM	4	NA	150	-0.1
HUNT (J.B.) TRANSPORT SERVICES JBHT	495.4	-7	1.6	-67	0.3	0.9	6.1	7.6	19	4	24	629	0.1
LANDSTAR SYSTEM LSTR	331.3	1	8.4	0	2.5	2.6	26.8	38.9	13	-6	28	581	5.1
ROADWAY EXPRESS ROAD	650.5	-4	5.0	-52	0.8	1.5	15.2	15.2	9	10	27	479	2.1
SWIFT TRANSPORTATION SWFT	327.4	12	1.2	-89	0.4	3.7	7.5	9.9	28	25	20	1213	0.1
UNITED PARCEL SERVICE UPS	7510.0	4	556.0	-32	7.4	11.3	18.8	27.5	25	17	-1	65892	2.1
USFREIGHTWAYS USFC	621.4	0	8.5	-62	1.4	3.6	9.7	13.1	9	23	25	699	3.1
WERNER ENTERPRISES WERN	304.6	5	9.5	-8	3.1	3.5	6.5	8.7	21	12	8	975	0.1
YELLOW YELL	832.0	-6	1.7	-83	0.2	1.2	10.3	13.2	8	1	17	445	2.1



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CORPORATE SCOREBOARD

COMPANY SYMBOL	SALES		PROFITS		MARGINS		RETURN		5-YEAR GROWTH				MARKET VALUE SHARES OUTSTANDING 5-3 \$ MIL	12 MONTH EARNIN PER SHAR
	1ST QUARTER 2001 \$ MIL.	CHANGE FROM 2000 %	1ST QUARTER 2001 \$ MIL.	CHANGE FROM 2000 %	1ST QUARTER 2001 %	1ST QUARTER 2000 %	ON INVESTED CAPITAL %	ON COMMON EQUITY %	P-E 5-3	COMMON EQUITY %	EARNINGS PER SHARE %			
24 UTILITIES & ENERGY SERVICES														
INDUSTRY COMPOSITE	260360.3	119	7046.2	-1	2.7	6.0	6.1	9.8	24	8	4	492285	1.63	
(A) ELECTRIC, WATER & COGENERATION														
GROUP COMPOSITE	152375.6	94	4999.2	-2	3.3	6.5	5.7	9.1	24	6	4	352149	1.58	
AES AES †	2545.0	50	106.0	-61	4.2	16.2	6.8	11.9	46	53	29	23247	1.05	
ALLEGHENY ENERGY AYE	1814.3	109	101.8	16	5.6	10.1	8.9	18.8	17	-5	8	5513	2.91	
ALLETE ALE	400.0	38	32.9	8	8.2	10.5	9.9	16.4	11	10	10	1782	2.14	
ALLIANT ENERGY LNT	852.7	49	35.1	67	4.1	3.7	10.2	19.4	6	37	10	2423	5.04	
AMEREN AEE	1024.5	24	68.5	6	6.7	7.8	7.5	14.6	12	7	2	5597	3.30	
AMERICAN ELECTRIC POWER AEP	13542.0	121	266.0	90	2.0	2.3	3.7	5.3	35	10	-16	15280	1.33	
AMERICAN WATER WORKS AWK	316.4	3	23.5	-13	7.4	8.8	6.0	9.3	19	15	4	3011	1.54	
AVISTA AVA	2100.7	52	29.4	179	1.4	0.8	7.7	14.9	9	-6	-19	956	2.30	
CALPINE CPN	1229.3	445	93.7	417	7.6	8.0	6.5	17.9	39	118	68	15494	1.35	
CINERGY CIN	3706.5	134	121.1	-13	3.3	8.8	7.6	13.4	14	2	2	5486	2.30	
CMS ENERGY CMS	4126.0	126	109.0	45	2.6	4.1	3.5	3.0	52	11	-23	3531	0.50	
CONNECTIV CIV	1554.6	49	45.9	22	3.0	3.6	7.6	15.4	11	7	-3	1948	1.90	
CONSOLIDATED EOISON EO	2886.3	24	182.5	-5	6.3	8.3	6.4	10.5	13	-1	0	7688	2.70	
CONSTELLATION ENERGY GROUP CEG	1165.1	17	106.6	41	9.1	7.6	6.9	11.9	19	2	4	7134	2.50	
DOMINION RESOURCES O	3156.0	53	162.0	-4	5.1	8.1	5.5	6.2	37	6	-3	16100	1.70	
DPL DPL	398.3	3	63.8	27	16.0	13.0	12.0	33.5	13	-2	13	3565	2.20	
DQE OQE	320.5	2	12.2	-72	3.8	13.8	5.5	14.0	12	-8	1	1196	1.80	
OTE ENERGY OTE	1842.0	56	138.0	18	7.5	9.9	8.2	12.2	12	4	6	5863	3.40	
DUKE ENERGY DUK	16491.0	126	554.0	41	3.4	5.4	10.3	19.1	17	17	3	32900	2.50	
ENERGY EAST EAS	1271.1	86	116.1	24	9.1	13.7	7.4	15.1	9	-2	14	2327	2.20	
ENTERGY ETR	2652.4	46	160.9	48	6.1	6.0	5.9	10.5	12	2	10	8883	3.20	
EXELON EXC	3823.0	183	387.0	132	10.1	12.3	4.6	11.0	NA	-1	5	21421	NA	
FIRSTENERGY FE	1985.7	23	123.1	-23	6.2	9.9	6.9	12.1	12	16	6	6615	2.50	
FPL GROUP FPL	1941.0	32	115.0	-8	5.9	8.5	8.0	12.4	14	5	6	10136	4.00	
GPU GPU	1300.4	11	70.3	-47	5.4	11.3	4.5	5.0	24	3	-6	4045	1.40	
HAWAIIAN ELECTRIC INDUSTRIES HE	434.9	8	28.2	-4	6.5	7.3	3.7	5.3	27	3	-8	1214	1.30	
MIRANT MIR	8182.0	NM	175.0	84	2.1	18.3	7.8	10.0	28	NA	NA	13260	1.30	
MONTANA POWER MTP	379.2	93	61.1	95	16.1	16.0	8.6	9.2	15	NA	9	1556	0.90	
NISOURCE NI	3798.1	243	186.1	129	4.9	7.3	4.4	7.2	22	19	-4	6065	1.30	
NORTHEAST UTILITIES NU	1800.5	30	137.3	73	7.6	5.7	6.0	11.4	10	-2	21	2592	1.80	
NORTHWESTERN NOR	1496.7	12	16.7	15	1.1	1.1	NM	14.4	13	19	11	572	1.90	
NRG ENERGY NRG †	624.3	88	35.2	302	5.6	2.6	7.1	10.8	27	NA	NA	6501	1.20	
NSTAR NST	864.8	31	-132.3	NM	NM	5.6	3.3	0.4	NM	8	7	2127	0.10	
OGE ENERGY OGE	1063.6	83	-15.0	NM	NM	0.1	6.5	12.3	13	3	5	1682	1.60	
PG&E PCG	6675.0	33	-951.0	NM	NM	5.6	NM	NM	NM	-15	NA	3220	-12.50	
PINNACLE WEST CAPITAL PNW	938.8	92	62.2	15	6.6	11.1	7.5	13.0	13	5	9	4114	3.60	
POTOMAC ELECTRIC POWER POM	560.8	7	64.9	569	11.6	1.8	11.8	21.9	6	0	26	2362	3.40	
PPL PPL	1566.0	11	228.0	54	14.6	10.5	10.6	28.4	14	-9	12	7731	3.90	
PROGRESS ENERGY PGN	1908.1	118	154.0	81	8.1	9.7	5.1	10.0	13	14	3	8746	3.20	
PUBLIC SERVICE CO. OF NEW MEXICO PNM	736.5	129	63.7	190	8.7	6.8	8.8	15.4	10	6	7	1407	3.50	
PUBLIC SERVICE ENTERPRISE GROUP PEG	2814.0	13	254.0	-6	9.0	10.9	8.7	18.7	13	-7	7	9340	3.50	
PUGET ENERGY PSD	1119.9	73	87.0	11	7.8	12.1	7.0	13.6	10	4	4	2003	2.20	
RELIANT ENERGY REI	13284.3	215	208.2	56	1.6	3.2	9.7	15.4	16	7	22	13852	2.90	
RGS ENERGY GROUP RGS	507.8	32	46.3	18	9.1	10.2	7.2	12.4	13	0	7	1272	2.80	
SCANA SCG	1318.0	61	81.0	5	6.1	9.4	6.4	11.1	13	6	2	2911	2.10	
SOUTHERN SO	2270.0	11	329.5	32	14.5	12.2	6.3	10.0	14	3	0	15301	1.60	
TECO ENERGY TE	672.6	28	69.7	30	10.4	10.2	11.8	17.7	15	5	2	3918	2.00	
TXU TXU	8375.0	75	200.0	2	2.4	4.1	7.2	11.8	12	8	3	11135	3.40	
UTILICORP UNITED UCU	11980.0	160	73.5	35	0.6	1.2	7.4	12.6	15	NA	12	3536	2.30	
WISCONSIN ENERGY WEC	1355.0	116	77.6	52	5.7	8.1	5.9	9.0	14	1	-5	2508	1.50	
WPS RESOURCES WPS	997.4	150	24.3	19	2.4	7.5	8.3	11.3	14	4	2	861	2.30	
XCEL ENERGY XEL	4207.1	81	209.3	37	5.0	6.6	7.0	10.7	17	17	-5	10222	1.70	
(B) GAS, OIL & ENERGY SERVICES														
GROUP COMPOSITE	107984.7	166	2047.0	3	1.9	4.9	7.6	12.5	25	20	5	140136	1.70	
AGL RESOURCES ATG ⁽³⁾	350.6	119	53.9	122	15.4	15.2	10.5	16.8	12	3	14	1219	1.90	
ATMOS ENERGY ATO ⁽³⁾	675.1	115	44.1	49	6.5	9.4	8.4	10.8	15	22	-7	909	1.60	
OYNEGY DYN	14167.5	165	137.5	99	1.0	1.3	7.7	14.9	33	33	15	17746	1.60	
EL PASO EPG	17754.0	96	-390.0	NM	NM	3.7	4.0	0.8	66	33	25	15296	0.90	
ENERGEN EGN ⁽³⁾	333.5	61	47.0	14	14.1	19.8	NA	18.3	17	19	14	1068	2.00	
ENRON ENE	50129.0	281	406.0	20	0.8	2.6	7.7	9.3	49	29	10	43857	1.20	
EQUITABLE RESOURCES EQT	851.2	127	71.3	82	8.4	10.4	13.5	19.9	18	2	86	2433	4.10	
KEYSPAN KSE	2641.6	101	224.8	30	8.5	13.1	6.9	12.2	15	35	-3	5208	2.50	
KINDER MORGAN KMI †	347.5	28	56.8	23	16.3	9.6	5.4	10.8	34	38	5	6475	1.60	

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CORPORATE SCOREBOARD

COMPANY SYMBOL	SALES		PROFITS		RETURN				5-YEAR GROWTH			MARKET VALUE SHARES OUTSTANDING \$ MIL	12 MONTH EARNINGS PER SHARE
	1ST QUARTER 2001 \$ MIL	CHANGE FROM 2000 %	1ST QUARTER 2001 \$ MIL	CHANGE FROM 2000 %	MARGINS		ON INVESTED CAPITAL %	ON COMMON EQUITY %	P-E 5-3	COMMON EQUITY %	EARNINGS PER SHARE		
					1ST QUARTER 2001 %	1ST QUARTER 2000 %							
LACLEDE GAS LG ⁽³⁾	442.7	86	20.7	6	4.7	8.2	8.1	11.7	13	5	-2	460	1.9
MDU RESOURCES GROUP MDU	641.2	72	32.7	144	5.1	3.6	8.4	14.7	19	22	11	2526	2.0
NATIONAL FUEL GAS NFG ⁽³⁾	879.9	70	75.3	6	8.6	13.7	8.4	14.6	15	4	4	2107	3.4
NEW JERSEY RESOURCES NJR ⁽³⁾	890.0	141	33.0	4	3.7	8.6	7.1	14.3	15	4	7	755	2.8
NICOR GAS	1473.7	124	38.8	0	2.6	5.9	6.2	6.6	37	1	-9	1709	1.0
NUI NUI ⁽³⁾	423.9	52	14.8	-17	3.5	6.3	6.0	9.3	12	12	20	288	1.8
OCEAN ENERGY OEI	403.3	60	123.4	187	30.6	17.1	15.2	22.6	10	19	99	2937	1.6
ONEOK OKE	2956.3	260	67.0	10	2.3	7.4	7.9	8.9	14	32	14	1220	3.0
PEOPLES ENERGY PGL ⁽³⁾	1073.8	104	62.5	9	5.8	10.9	8.9	12.8	14	4	3	1376	2.7
PIEDMONT NATURAL GAS PNY ⁽²⁾	467.6	74	50.3	14	10.8	16.4	8.4	12.3	16	8	6	1100	2.1
QUESTAR STR	562.6	67	64.9	29	11.5	14.9	10.8	17.3	14	7	9	2438	2.1
SEMPRA ENERGY SRE	3255.0	126	185.0	57	5.7	8.2	9.9	19.8	11	20	5	5478	2.4
SOUTH JERSEY INDUSTRIES SJI	342.6	105	20.8	5	6.1	11.8	7.3	12.7	14	4	5	351	2.2
SOUTHERN UNION SUG ⁽⁶⁾	914.7	165	40.8	109	4.5	5.7	3.6	5.7	31	21	-16	1070	0.6
SOUTHWEST GAS SWX	487.5	64	33.8	34	6.9	8.5	6.1	8.8	14	9	69	658	1.4
UGI UGI ⁽³⁾	943.8	55	45.9	17	4.9	6.4	6.4	19.9	12	-9	35	698	2.1
VECTREN VVC	883.1	146	40.7	82	4.6	6.2	8.5	12.3	15	15	3	1376	1.4
WGL HOLDINGS WGL ⁽³⁾	605.2	54	67.2	3	11.1	16.6	8.5	12.0	14	7	1	1313	2.0
WILLIAMS WMB	3088.0	63	378.3	172	12.3	7.3	8.4	18.9	17	16	-2	18065	2.0

ALPHABETICAL LIST OF COMPANIES

The number following each company name identifies the Scoreboard category under which it is listed

A&P 10c
Abbott Laboratories 12b
Abercrombie & Fitch 8
ABM Industries 21d
ACT Mfg. 9d
ADC Telecomm. 22a
Adminstaff 21d
Adobe Systems 18c
Advanced Micro 9d
AES 24a
Affiliated Computer Svcs. 18c
AFLAC 17b
AGCD 15c
Agere Systems 9d
Agilent Technologies 9c
AGL Resources 24b
Air Products & Chemicals 4
Airborne 23c
AK Steel Holding 16b
Alaska Air Group 23a
Alberto-Culver 8
Albertson's 10c
Alcoa 16a
Allegheny 17b
Allegheny Energy 24a
Allegheny Tech. 5
Allergan 12b
Allete 24a
Alliant Energy 24a
Allstate 17b
Altell 22b
Alza 12b
Amazon.com 8
Amerade Hess 11a
Ameren 24a
American West Holdings 23a
American Axle & Mfg. 2b
American Eagle Outfitters 8
American Electric 24a
American Express 17a
American Financial Group 17b
American General 17b
American Greetings 14d
American Home 12b
American Intl. Group 17b
American Management 18c
American National 17b
American Standard 13a
American Water Works 24a
AmeriSource Health 12a

Ames Dept. Stores 8
Amgen 12b
Amkor Technology 9d
Amphenol 9d
AMR 23a
AmSouth Bancorporation 3c
Amtran 23a
Anadarko Petroleum 11a
Analog Devices 9d
ANC Rental 23c
Anheuser-Busch 6c
Anixter International 5
Antitaylor Stores 8
AOL Time Warner 18c
Aon 17b
Apache 11a
Apartment Investment 13b
Apple Computer 18b
Applied Biosystems 9c
Applied Industrial Tech. 21b
Applied Materials 15c
Arch Coal 11a
Arch Wireless 22a
Archer Daniels 10b
Arkansas Best 23d
Arrow Electronics 21b
ArvinMeritor 2b
Ashland 11a
Astoria Financial 17c
AT&T 22a
AT&T Wireless 22a
Atmel 9d
Atmos Energy 24b
Audiovox 21b
Autoliv 2b
Automatic Data 18c
AutoNation 21d
AutoZone 8
Avaya 9b
Avery Dennison 15a
Avista 24a
Avnet 21b
Avon Products 6d
AVX 9d

B

Baker Hughes 11b
Ball 7a
BancWest 3d
Bank of America 3c
Bank of New York 3a

B

Hughes 11b
 7a
 West 3d
 of America 3c
 of New York 3a

Bank One 3b
Banknorth Group 3a
Banta 21c
Barnes & Noble 8
Bausch & Lomb 12d
Baxter International 12d
BB&K 3c
Bear Stearns 17a
Beazer Homes USA 13b
Beckman Coulter 9c
Becton, Dickinson 12c
Bed Bath & Beyond 6b
Bell Microproducts 21b
Bell South 22b
Belo 20b
Bemis 7b
Benchmark Electronics 9d
Bergen Brunswig 12a
Berkley (W.R.) 17b
Best Buy 6b
Bethlehem Steel 1b
BJ Services 11b
B.J.'s Wholesale Club 8
Black & Decker 15b
Block (H&R) 17a
Blockbuster 14b
Blyth 15a
BMC Software 18c
Boeing 1
Boise Cascade 19b
Borders Group 8
BorgWarner 2b
Boston Scientific 12d
Bowater 19b
Briggs & Stratton 15c
Brightpoint 21b
Brinker International 14a
Bristol-Myers Squibb 12b
Broadcom 9d
Broadwing 22b
Brown Shoe 6a
Brown-Forman 6c
Brunswick 14d
Budget Group 23c
Burlington Coat Factory 8
Burlington Industries 15d
Burlington Northern Santa Fe
Burlington Resources 11a

C

Cabot 4
Cadence Design Systems **18c**
Calpine **24a**
Campbell Soup **10b**
Capital One Financial **17a**
Cardinal Health **12a**
Caremark Rx **12a**
Carlisle **15a**
CarMax Group **21d**
Carnival **14d**
CarperTech **16b**
Casey's General Stores **21d**
Caterpillar **15c**
CBRL Group **14a**
CDI **21d**
CDW Computer Centers **8**
CellStar **21b**
Cendant **21d**
Centex **13b**
CenturyTel **22a**
Ceridian **18c**
Champion Enterprises **13b**
Charming Shoppes **8**
Charter Communications **20a**
Charter One Financial **17c**
Chevron **11a**
Chiquita Brands Intl **10b**
Chubb **17b**
Ciena **22a**
Cigna **17b**
Cincinnati Financial **17b**
CIMergy **24a**
Cintas **21d**
Circuit City Group **6b**
Cisco Systems **18c**
CIT Group **17a**
Citigroup **17a**
CKE Restaurants **14a**
Claire's Stores **8**
Clear Channel Commun. **20a**
Clorox **6d**
CMGI **18c**
CMS Energy **24a**
CNF **23c**
Coca-Cola **6c**
Coca-Cola Enterprises **6c**
Colgate National **8**
Colgate-Palmolive **6d**
Comdisco **18c**
Comerica **3b**

Commercial Metals 16b
Community Health Sys. 12c
Compaq Computer 18b
CompuCom Systems 18a
Compuware 18c
Converse Tech. 22a
ConAgra Foods 10b
Concord EFS 17a
Connectiv 24a
Conoco 11a
Conseco 17b
Consol Energy 11a
Consolidated Edison 24a
Cons. Freightways 23d
Consolidated Stores 8
Constellation Brands 6c
Constellation Energy 24a
Continental Airlines 23a
Convergys 21d
Cooper Cameron 11b
Cooper Industries 9a
Cooper Tire & Rubber 2b
Coors (Adolph) 6c
Corn Products Intl. 10b
Corning 22a
Costco Wholesale 8
Countrywide Credit 17a
Coventry Health Care 12c
Cox Communications 20a
Crane 15c
Crompton 4
Crown Cork & Seal 7a
CSK Auto 8
CSX 23b
Cummins 15c
CVS 12a
Cytac Industries 4

B

D&K Healthcare Resources **12a**
 Dana **2b**
 Danaher **9c**
 Darden Restaurants **14a**
 Dean Foods **10b**
 Deere **15c**
 Del Monte Foods **10b**
 Delhaize America **10c**
 Dell Computer **18b**
 Delphi Automotive **2b**
 Delta Air Lines **23a**
 Deluxe **18a**

Devon Energy 11a
Dial 6d
Diebold 18a
Dillard's 8
Dime Bancorp 17c
Disney (Walt) 20a
Dole Food 10b
Dollar General 8
Dollar Tree Stores 8
Dominion Resources 24a
Donnelley (R.R.) 21c
Dover 15c
Dow Chemical 4
Dow Jones 20b
DPL 24a
DQE 24a
DST Systems 18c
DTE Energy 24a
Duke Energy 24a
Dun & Bradstreet 17a
DuPont 4
Dura Automotive Systems 2b
Dynegy 24b

E

E*Trade Group 17a
Earthgrains 10b
Eastman Chemical 4
Eastman Kodak 14d
Eaton 2b
EchoStar Communications 20a
Ecolab 6d
Edwards (A.G.) 17a
El Paso 24b
Electronic Data Systems 18c
Electronics Boutique 8
EMC 18b
Emcor Group 21a

E

E*Trade Group **17a**
 Earthgrains **10b**
 Eastman Chemical **4**
 Eastman Kodak **14d**
 Eaton **2b**
 EchoStar Communications **20a**
 Ecolab **6d**
 Edwards (A.G.) **17a**
 El Paso **24b**
 Electronic Data Systems **18c**
 Electronics Boutique **8**
 EMC **18b**
 Emcor Group **21a**
 eMerge Interactive **8**
 Emerson Electric **9a**
 Energen **24b**
 Energizer Holdings **15a**
 Energy East **24a**
 Engelhard **16c**
 Enron **24b**
 Entergy **24a**
 EDG Resources **11a**
 Equifax **17a**
 Equitable Resources **24b**
 Equity Office Properties **13b**
 Estee Lauder **6d**

Exelon 24a
Exodus Communs. 18c
Express Scripts 12c
Exxon Mobil 11a

F

Fairchild Semiconductor **9d**
 Family Dollar Stores **8**
 Fannie Mae **17a**
 Federal-Mogul **2b**
 Federated Dept. Stores **8**
 FedEx **23c**
 Ferro **4**
 Fidelity National Finl. **17a**
 Fifth Third Bancorp **3b**
 Finlay Enterprises **8**
 First American **17a**
 First Data **18c**
 First Tennessee Natl. **3c**
 First Union **3c**
 FirstEnergy **24a**
 Fiserv **18c**
 Fisher Scientific **21b**
 FleetBoston Financial **3a**
 Fleetwood Ent's. **14d**
 Flowserve **15a**
 Flour **21a**
 FMC **15c**
 Footstar **8**
 Ford Motor **2a**
 Forest Laboratories **12b**
 Fortune Brands **15a**
 Foster Wheeler **21a**
 FPL Group **24a**
 Franklin Resources **17a**
 Freeport-McMoran C&G **16b**
 Frontier Dtl. **11a**
 Furr (H.B.) **4**
 Furniture Brands **6h**

G

Galileo Intl. **18c**
Gannett **20b**
Gap **8**
Gateway **18b**
GATX **23c**
GenCorp **2b**
Genentech **12b**
General Cable **16c**
General Dynamics **1**
General Electric **5**

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ALPHABETICAL LIST OF COMPANIES

The number following each company name identifies the Scoreboard category under which it is listed

General Mills 10b
General Motors 2a
Genuine Parts 21b
Genuity 18c
Georgia Gulf 4
Globe-Pacific Group 19a
Gillette 6d
Golden State Bancorp 17c
Golden West 17c
Goldman Sachs Group 17a
Goodrich (B.F.) 1
Goodyear Tire & Rubber 2b
Goody's Family Clothing 8
GPU 24a
Grace (W.R.) 4
Grainger (W.W.) 21b
Great A&P 10c
Great Lakes Chemical 4
GreenPoint Financial 17c
Group 1 Automotive 21d
Guidant 12d

H

Halliburton 11b
Handleman 21d
Harcourt General 20b
Harley-Davidson 14d
Harman International 6b
Harrah's Entertainment 14d
Harris 9b
Harsco 15a
Hartford Financial Services 17b
Hasbro 14d
Hawaiian Electric 24a
Hayes Lemmerz Intl. 2b
HCA-The Healthcare Co. 12c
Health Management Assocs. 12c
Health Net 12c
Healthsouth 12c
Heinz (H.J.) 10b
Heller Financial 17a
Hershey Foods 10b
Hewlett-Packard 18b
Hibernia 3c
Hillenbrand 15a
Hilton Hotels 14c
Home Depot 8
HomeBase 8
HON Industries 18a
Honeywell Intl. 5
Hormel Foods 10b
Horton (D.R.) 13b
Host Marriott 13b
Household Intl. 17a
Hub Group 23c
Hubbell 9a
Hughes Electronics 9b
Hughes Supply 21b
Humana 12c
Hunt (J.B.) 23d
Huntington Bancshares 3b

I

I2 Technologies 18c
IBM 18b
IBP 10b
IKON Office Solutions 5
Illinois Tool Works 15c
Imation 18c
IMC Global 4
IMS Health 21d
Ingersoll-Rand 15c
Ingles Markets 10c
Ingram Micro 18c
Insight Enterprises 8
Intel 9d
Interleaf 15d
International Flavors 4
International Game Tech. 15a
Intl. Multifoods 10a
International Paper 19b
Interpublic Group 21c
Interstate Bakeries 10b
Intimate Brands 8
Intuit 18c

ITT Group 21a
ITT Industries 15c

J

J.P. Morgan Chase 3a
Jabil Circuit 9d
Jacobs Engineering 21a
JDS Uniphase 9d
Jefferson-Pilot 17b
Jo-Ann Stores 8
Johnson & Johnson 12d
Johnson Controls 15a
Jones Apparel Group 6a
Juniper Networks 18c

K

Kaiser Aluminum 16a
KB Home 13b
Kellogg 10b
Kellwood 6a
Kelly Services 21d
KEMET 9d
Kennametal 15b
Kerr-McGee 11a
KeyCorp 3b
KeySpan 24b
Kimball Intl. 6b
Kimberly-Clark 19b
Kinder Morgan 24b
KLA-Tencor 9c
Kmart 8
Knight-Ridder 20b
Kohl's 8
KPMG Consulting 21d

L

L-3 Communications 9b
Laboratory Corp. of America 12c
Laclede Gas 24b
Lafarge 13a
Lam Research 15c
LandAmerica Financial 17a
Lands' End 8
Landstar System 23d
La-Z-Boy 6b
Lear 2b
Leggett & Platt 6b
Lehman Brothers Holdings 17a
Lennar 13b
Lennox International 13a
Level 3 Comms. 22a
Lexmark Intl. 18b
Lilly (Eli) 12b
Limited 8
Lincoln National 17b
Linen's 'N Things 6b
Lithia Motors 21d
Litton Industries 1
Liz Claiborne 6a
Lockheed Martin 1
Loews 17b
Longs Drug Stores 12a
Louisiana-Pacific 19a
Lowe's 8
LSI Logic 9d
Lubrizol 4
Lucent Technologies 22a
Lyondell 4

M

M&T Bank 3a
M.O.C. Holdings 13b
Mail-Well 7b
Mandalay Resort 14b
Manor Care 12c
Manpower 21d
Manufacturers Services 9d
Market 17b
Marriott Intl. 14c
Marsh & McLennan 17a
Martin Marietta Materials 13a
MasTec 21a
Mattel 14d
Maxtor 18b

Maxam 16a
May Department Stores 8
Maytag 6b
McCormick 10b
McDermott Intl. 15c
McDonald's 14a
McGraw-Hill 20b
McKesson HBCO 12a
McLeodUSA 22a
MOU Resources Group 24b
Mead 19b
Medtronic 12d
Mellon Financial 3a
Men's Wearhouse 8
Merck 12b
Mercury General 17b
Merrill Lynch 17a
Metals USA 21b
Metris 17a
Metro-Goldwyn-Mayer 14b
MGM Mirage 14b
Michaels Stores 8
Micron Technology 9d
Microsoft 18c
Millacron 15c
Millennium Chemicals 4
Miller (Herman) 18a
Minnesota Mining 15a
Mirant 24a
Mitchell Energy 11a
Modis Professional Svcs. 21d
Mohawk Industries 15d
Molex 9d
Monsanto 4
Montana Power 24a
Morgan Stanley Dean Witter 17a
Motorola 9b
Murphy Oil 11a

N

Nabors Industries 11b
Nacco Industries 15b
Nash Finch 10a
National City 3b
National Commerce 3c
National Fuel Gas 24b
National Semicond. 9d
National Service 9a
National Steel 16b
National-Oilwell 11b
Nationwide Financial Svcs. 17b
Navistar International 2a
NCR 18a
Neiman Marcus Group 8
New Jersey Resources 24b
New York Times 20b
Newell Rubbermaid 15a
Newmont Mining 16c
Newport News Shipbuilding 1
Nexel Communications 22a
Nicor 24b
Nike 6a
Nisource 24a
Noble Affiliates 11b
Nordstrom 8
Norfolk Southern 23b
Nortek 13a
North Fork Bancorp. 3a
Northeast Utilities 24a
Northern Trust 3b
Northrop Grumman 1
Northwestern Airlines 23a
Northwestern 24b
NOVA 21d
Novellus Systems 15c
NRG Energy 24a
NSTAR 24a
Nucor 16b
NUI 24b
NVR 13b
Occidental Pet. 11a
Ocean Energy 24b

Office Depot 8
OfficeMax 8
OGE Energy 24a
Ohio Casualty 17b
Old Republic Intl. 17b
Olin 15c
Omnicare 12a
Omnicon Group 21c
ON Semiconductor 9d
Oneok 24b
Oracle 18c
Oshkosh Truck 2a
Outback Steakhouse 14a
Owens & Minor 12d
Owens Corning 13a
Owens-Illinois 7a
Oxford Health Plans 12c

P

Paccar 2a
Pacific Century Fin. 3d
PacificCare Health 12c
Packaging Corp. America 7b
Pactiv 7b
Pall 5
Palm 18b
Pantry 21d
Park Place Entertainment 14b
Parker Hannifin 15a
Pathmark Stores 10c
Paychex 21d
Payless ShoeSource 8
PC Connection 8
Penn Traffic 10c
Penney (U.C.) 8
Pentair-Quaker State 11a
Pentair 12b
Peoples Energy 24b
PeopleSoft 18c
Pep Boys 8
Pepsi Bottling Group 6c
PepsiAmericas 5
PepsiCo 6c
Performance Food 10a
PerkinElmer 9c
PetSmart 8
Pfizer 12b
PG&E 24a
Pharmacia 12b
Phelps Dodge 16c
Philip Morris 6e
Phillips Petroleum 11a
Phillips-Van Heusen 6a
Piedmont Natural Gas 24b
Pier 1 Imports 6b
Pilgrim's Pride 10b
Pinnacle West 24a
Pitney Bowes 18a
Pittsburg 23c
PNC Financial Svcs. 3a
Polaroid 14d
PolyOne 4
Popular 3c
Potlatch 7b
Potomac Electric 24a
PPG Industries 13a
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Praxair 4
Precision Castparts 1
Primedia 20b
Procter & Gamble 6d
Progress Energy 24a
Progressive 17b
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PS Co. of New Mexico 24a
Public Service Ent. 24a
Puget Energy 24a
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Quaker Oats 10b
Qualcomm 9b
Quanta Services 21a
Quantum QLT & Storage Sys. 18b
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Questar 24b
Quintiles Transnational 21d
Qwest Comms. 22b

R

R.J. Reynolds Tobacco 6e
RadioShack 6b
Ralston Purina 10b
Raymond James Finl. 17a
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Regions Financial 3c
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Reliance Steel & Alum. 21b
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Revlon 6d
RGS Energy Group 24a
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Robert Half International 21d
Robinson (C.H.) 23c
Rock-Tenn 7b
Rockwell International 9a
Rohm & Haas 4
Ross Stores 8
Royal Caribbean Cruises 14d
RPM 13a
Ruddick 10c
Ryder System 23c
Ryerson Tull 16b
Ryland Group 13b

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Sabre Holdings 18c
Safeco 17b
Safeway 10c
Saks 8
Scannia 9d
Sara Lee 10b
SBC Communications 22b
Scana 24a
Schering-Plough 12b
Schlumberger 11b
Scholastic 20b
Schwab (Charles) 17a
SCI Systems 9d
Scientific Atlanta 22a
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Scripps (E.W.) 20b
Sealed Air 7b
Sears, Roebuck 8
Sempra Energy 24b
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7-Eleven 10c
Shaw Group 15a
Sherwin-Williams 8
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Siebel Systems 18c
Sierra Health Services 12c
Sigma-Aldrich 12b
Silgan Holdings 7a
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Smurfit-Stone Container 7b
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Sodexo Marriott 14a
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Sonic Automotive 21d
Sonoco Products 7b
South Jersey Inds. 24b
Southern 24a
Southern Union 24b
South Trust 3c
Southwest Airlines 23a
Southwest Gas 24b
Sovereign Bancorp 17c
Spherion 21d

Spiegel 8
Sports Authority 8
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Sprint FON Group 22a
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St. Jude Medical 12d
St. Paul 17b
Staff Leasing 21d
StanCorp Financial Group 17b
Standard Register 18a
Stanley Tools 15b
Staples 8
Starbucks 10b
Starwood Hotels & Resorts 14c
State Street 3a
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Stewart & Stevenson 15c
Stillwell Financial 17a
Storage Technology 18b
Stryker 12d
Student Loan 17a
Suiza Foods 10b
Sun Microsystems 18b
SunGard Data Systems 18c
Sunoco 11a
SunTrust Banks 3c
Superior TeleCom 16c
Supervalu 10a
Swift Transportation 23d
Synovus Financial 3c
Sysco 10a

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Target 8
TCF Financial 3b
TO Waterhouse Group 17a
Tech Oata 18a
Teco Energy 24a
Tecumseh Products 13a
Tektronix 9c
Teleflex 15a
Telephone & Data Sys. 22a
Tellabs 22a
Temple-Inland 7b
Tenet Healthcare 12c
Tenneco Automotive 2b
Teradyne 9c
Terex 15b
Tesoro Petroleum 11a
Texaco 11a
Texas Instruments 9d
Textron 5
Thermo Electron 9c
Thomas & Betts 9d
3Com 18c
3M 15a
Tiffany 8
Timken 15c
TJX 8
Toll Brothers 13b
Torchmark 17b
Tosco 11a
Tower Automotive 15a
Toys 'R' Us 8
Trans World Entertainment 14d
Transatlantic Holdings 17b
Tribune 20b
Tricon Global Restaurants 14a
True North Comms. 21c
Trump Hotels 14b
TRW 5
TXU 24a
Tyco Intl. 15c
Tyson Foods 10b

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U.S. Bancorp 3b
U.S. Cellular 22a
U.S. Office Products 21b
UAL 23a
UGI 24b
Ultramar Diamond Shamrock 11a
Union Pacific 23b

Union Planters 3c
UnionBanCal 3d
Unisys 18b
United Auto Group 21d
United Parcel Service 23d
United Rentals 21d
United States 21b
United Technologies 1
UnitedHealth Group 12c
Unitrin 17b
Universal 6e
Universal Health 12c
Unocal 11a
Unova 15c
URS 21a
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USA Education 17a
USA Networks 20a
USFreightways 23d
USG 13a
UST 6e
USX-Marathon 11a
USX-U.S. Steel 16b
UtiliCorp United 24a

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Valero Energy 11a
Valspar 13a
Value City 8
Vectrac 24b
Venator Group 8
Veritas Software 18c
Verizon Communications 22
VF 6a
Viacom 14b
Viad 5
Viaysystems Group 9d
Vishay Intertechnology 9d
Visteon 2b
Volt Info. Sciences 21d
Vulcan Materials 13a

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Wachovia 3c
Walgreen 12a
Wallace Computer 18a
Wal-Mart Stores 8
Walter Industries 16b
Washington Mutual 17c
Washington Post 20b
Weatherford Intl. 11b
Webb (Dei) 13b
Weis Markets 10c
WellPoint Health 12c
Wells Fargo 3b
Wendy's Intl. 14a
Werner Enterprises 23d
WESCO International 21b
Western Digital 18b
WestPoint Stevens 15d
Westvaco 7b
Weyerhaeuser 19b
WGL Holdings 24b
Whirlpool 6b
Willamette Industries 19b
Williams 24b
Williams-Sonoma 6b
Wilsons Leather 8
Winn-Dixie Stores 10c
Wisconsin Energy 24a
WorldCom 22a
Worthington Inds. 16b
WPS Resources 24a
Wrigley (Wm.) Jr. 10b

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Xcel Energy 24a
Xerox 18b
Xilinx 9d
Yellow 23d
York Intl. 13a
Zale 8
Zions Bancorporation 3d



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LITIGATION

ATTACK OF THE TRIAL LAWYERS

With tort reform on hold in Washington, Corporate America finds itself on the defensive in the states

On the issue of tort reform, last year's Presidential candidates presented a stark contrast. Al Gore was against it and got almost every dime contributed by plaintiffs' attorneys. George W. Bush was for it and raked in millions from powerful litigation targets such as Big Tobacco, drugmakers, and insurers.

Since Corporate America bet on the right guy, you'd expect it to be winning the war to cut down on lawsuits. But that's not the way things are turning out. While Bush is still committed to tort reform, the issue is all but dead on Capitol Hill this year. What's more, it looks unlikely that in the near future W. will be able to push through any legislation that seriously tilts the balance of power in courtrooms in favor of big companies.

Meanwhile, as tort reform languishes in Washington, plaintiffs' lawyers are on the verge of winning an important victory in the states. Feeding off outrage over last year's Firestone tire debacle, they are expected to win legislation in California barring companies from striking secret settlements with injury victims and making it harder to preserve the confidentiality of corporate documents turned over in litigation. Similar proposals are under consideration in 12 other states. Defense attorneys are worried that the legislation will make it tougher for companies to shield sensitive internal information, giving



their opponents a huge tactical advantage in the courtroom.

Bottom line: The plaintiffs' lawyers are winning the battle over tort reform at a time when they were supposed to be on the defensive. This turn of events is causing consternation in executive suites across the country. It's also leading to some soul-searching about why tort reform doesn't have wider public support. "We have not done a good enough job making the case for legal reform," says Steven B. Hantler, assistant general counsel at DaimlerChrysler. He argues that clamp-

ing down on litigation would lower corporate costs, thereby helping consumers. But he acknowledges that "the trial lawyers have done a better job of convincing people that [tort reform is] just a coverup for companies that want to escape responsibility" for misdeeds. This pessimistic mood is quite a change from last year. When Bush was in the campaign trail, executives hoped far-reaching tort reform would be just a matter of time if he won. High on his wish list was legislation forcing the loss of tort lawsuits to pay for the other side's legal expenses—known as "loser pay"—making it riskier to take on giant defendants. Corporate lobbyists also wanted cuts on punitive damage awards.

At the moment, these proposals seem impossibly out of reach. In fact, the only reforms that seem attainable in the next couple of years are marginal changes in rules governing class actions. Companies hope to win support for legislation that would make it easier for them to move class actions that have been filed in state courts into federal courts, which are generally friendlier to large corporate defendants. But that measure doesn't do much to excite executives. "It's a modest reform at best," says Robert W. Pike, executive vice-president of Allstate Insurance Co.

LOST PALS. The main reason prospects for federal tort reform are gloomy is the Senate. Last year, some of the chamber's most ardent crusaders for the issue lost their reelection bids. When the Senate split 50-50, the GOP is short of the 60 votes it would need to break a Democratic filibuster.

But the Senate isn't the only problem. For one thing, grassroots support for major tort reform isn't as widespread as Corporate America might have hoped. The Ford-Firestone tire debacle is only part of the reason. Many of the industries targeted by plaintiffs' lawyers, including tobacco, HMOs, and drugmakers, are not especially popular with voters. While every particular reform

WHY TORT REFORM IS NOWHERE IN SIGHT

DIVIDED SENATE Republican tort reform supporters would need 60 votes in the Senate. They don't have them.

FORD-FIRESTONE Public anger about the blowout problem chilled congressional enthusiasm for tort reform.

COUNTERATTACK IN THE STATES Plaintiffs' lawyers are pushing legislation in 13 states limiting the ability of companies to keep sensitive internal documents private.

Date: BusinessWeek

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**we increased profits
and improved margins.**

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proposed, tort lawyers counterattack by portraying it as an industry bailout. For legislation to pass, says Robert E. Litan, director of economic studies at the Brookings Institution, "it can't be seen as pro-tobacco or pro-gun industry."

Anger at Big Business is also driving the California legislation. Some state lawmakers believe the Firestone tire problem would have come to light much sooner if the company hadn't reached secret settlements with victims who filed the first lawsuits. Legislators also remember that insurers struck confidential deals with some homeowners who suffered property damage during the 1994 earthquake in Northridge, Calif.—thereby preventing other policyholders from discovering they could make similar pacts. So there's broad support for banning secret settlements.

Most companies say they can live with that. But they are dismayed by a proposal tort attorneys have piggy-backed on it. The provision would make it harder to obtain protective orders, which companies seek to keep opponents from publicizing documents handed over in litigation. Specifically, defense lawyers would have to prove that their clients have an "overriding interest" in keeping the material private. That's tougher than the current standard, which only requires them to show they have "good cause" for secrecy.

REARGUARD ACTION. The proposed California law, companies say, would make it more difficult to protect the confidentiality of marketing documents, pricing data, long-term strategic plans—everything but clearly proprietary trade secrets. "It is an unfair edge," claims Los Angeles litigator Michael K. Brown. "For \$194, you can go to the courthouse, file a complaint, allege something is wrong, and then all this information becomes public."

Supporters of the bill, including the California Newspaper Publishers Assn., don't see anything wrong with that. If an embarrassing document surfaces in litigation, they argue, then it shouldn't be suppressed. Rather, the company should offer up more documents to put it in perspective. "What are they so afraid of?" asks Bruce Broillet, president of the Consumer Attorneys of California. "The lawsuits they're worried about aren't the frivolous ones. They're worried about the serious cases that involve people's lives and well-being."

Corporate lawyers dispute that point, but right now they appear to be losing the battle in California. Moreover, they're in a rearguard action to block similar laws elsewhere. That's hardly the position they thought they'd be in when Bush took the White House.

By Mike France in New York, with Dan Carney in Washington

People



FIRST COURSE? Smithfield's chief pigs out, but he's mulling a move into b

EMPIRE BUILDERS

WHO'S AFRAID OF A LITTLE MUD?

Hog king Joe Luter is used to being deep in controversy

Joe Luter likes to tell a story about an old man who was walking with his grandson around a cemetery. They see a tombstone that reads: "Here lies Charles W. Johnson, a man who had no enemies." The little boy says: "Gee, granddad, this man must have been a great man. He had no enemies." "Son," the grandfather replies, "if a man didn't have any enemies, he didn't do a damn thing with his life."

By that measure, Joseph W. Luter III, 61, has certainly lived a rich, full life. Environmentalists, animal-rights activists, and independent farmers all rail against Luter, the chairman, CEO, and president of Smithfield Foods Inc., the

largest hog butcher in the world. Now Carolina, worried about hog-waste spilling from huge lagoons into its waterways, imposed a moratorium on Smithfield's expansion. Animal-welfare fans say the company cruelly confines pigs in narrow pens. And small farmers blame big corporations for depressing pork prices. "These guys are not businessmen making a buck. They're bullies," says Robert F. Kennedy Jr., the environmental attorney who is leading the court battle against Smithfield. Luter shrugs off the attacks: "I think in America today if you become too successful you draw criticism, whether it's Smithfield in the pork business or Microsoft

HANDS-OFF "I'm a risk-taker; I'm an opportunist," Luter says. "I'm not a professional manager"



computer business or Exxon in the business."

But one group still adores Luter and Smithfield (Va.)-based company: shareholders. After muscling its way into hog farming and riding a wave of processing consolidation, Smithfield has more than doubled sales since 1996. It now controls 12% of hog farming—triple the size of its nearest competitor—and 40% of processing. The company expects sales to rise another 14%, to \$5.9 billion, in the fiscal year ended Apr. 29. Luter says net income should more than double, to \$169 million. Investors haveaped the rewards of Luter's feeding frenzy, with a nearly hundred-percent increase in Smithfield's share price since 1981, to a

market-adjusted \$34. "He's done it by following Warren Buffett's creed: Be greedy when others are fearful and fearful when others are greedy," says analyst David C. Nelson of Credit Suisse First Boston. Still, with mounting potential opposition to corporate pig farming and a desire to diversify his offering at supermarkets, he has to find new avenues of growth. That's what drove Smithfield's attempt last November to buy IBP Inc., the largest U.S. beef processor. Smithfield lost to Tyson Foods Inc., which later backed out of its deal amid a welter of legal suits. Smithfield then agreed to buy Moyer Packing Co., a smaller beef processor. That broadens its range of prepackaged, branded meat, which commands twice the profit margins of commodity meats, and boosts its distribution in the Northeast.

BOOTS NEEDED. These days, though, the closest Luter gets to pigs are the problems on his distinctive ties. He may sound like a man of the earth, eschewing corporate babble, but Luter ducts much of his business from an apartment on Park Avenue in Manhattan, leaving day-to-day operations to presidents of each of Smithfield's subsidiary companies. He can go weeks without talking to them. "I'm a risk-taker. I'm an opportunist," he says. "I'm not a professional manager." It's a far cry from how Luter got his start as a teenager working on the kill

floor of his father's business, Luter Packing Co., back in Smithfield. He went on to major in business administration at Wake Forest University and was mulling law school when his father died in 1962. That drew him back into the business. Luter started in sales but had much bigger plans. Borrowing every cent he could, he bought out non-family investors and made himself president at 26. "I was surviving on Alka-Seltzer for three years," he recalls. "I had bitten off more than I could chew." Overwhelmed, he sold out in 1969 to conglomerate Liberty Equities Corp. for \$20 million. But Liberty ran Smithfield

average, the industry uses three pounds of feed to produce a pound of pork; Smithfield's rate is 2.6 to 1.

"VISIONARY." Owning both the raw material and the processing protects Luter's operations from the cyclical nature of commodity price swings and lets him sell a consistent-quality product. But rivals still aren't sure whether Luter is ahead of them or just further out on a limb. "The gamble to invest enormously in hog production and to control the source of supply and quality of hogs is visionary," says Timothy T. Day, chairman and CEO of competing processor Bar-S Foods Co. "The question is, over 10 years, will it prove to be the right strategy?" Smithfield racked up \$1.1 billion in debt and has a 1-to-1 debt-to-equity ratio. But with \$500 million in earnings before interest, taxes, depreciation, and amortization, "this is not an overwhelming burden," says analyst Jeffrey G. Kanter of Prudential Securities Inc.

For now, Luter says he's content to watch the court battle between Tyson and IBP from the sidelines while studying how his own purchase of the smaller Moyer beef-processing operation unfolds. But that could quickly change as environmental and other concerns prohibit Smithfield from expanding in some of the richest hog-producing areas of the country. Laws aimed at limiting corporate farms are piling up in states like Iowa and North Dakota. And complaints about environmental hazards of huge hog farms are mounting. Luter claims his company's methods are safe and that by spraying the accumulated waste onto surrounding croplands, "it's really organic farming." But environmentalists assert that it will cost \$10 billion just to clean up North Carolina's Neuse River. South Carolina Governor Jim Hodges said in April the company was not welcome in that state either. Luter may be out in front in his industry, but he's got a barnyard full of detractors close behind who would love to tan his hide.

By Julie Forster in New York

JOSEPH W. LUTER III



BORN

July 17, 1939, Smithfield, Va.

EDUCATION

B.A. in business administration, Wake Forest University, 1962

POSITION

Chairman, president, and CEO, Smithfield Foods Inc.

HOW HE STARTED

Carving up pigs in his dad's slaughterhouse

FAMILY BUSINESS

Smithfield Foods was founded in 1936 by his grandfather and father; son Joe IV is a senior vice-president and hopes to run the company some day

ENEMIES' LIST

Independent farmers, animal-rights activists, environmentalists

HOBBIES

Grouse hunting, skiing

FAMILY

Wife, Karen; two daughters and one son from a previous marriage

into the ground, and its banks called upon Luter to manage a turnaround. He cut a whole layer of management, and divested anything that wasn't related to slaughtering or processing.

By 1981, Luter was in a position to expand. He bought Gwaltney's, his major local competitor, making Smithfield the dominant East Coast pork processor. He built the largest processing operation in the world in Bladen County, N.C.—today, it kills 32,000 hogs a day, twice that of a typical plant. Realizing there was more money in raising pigs than slaughtering them, Luter bought out his hog-farm partners in 1999 and 2000, as the price of hogs sank to a historic low of 8¢ a pound. Today, massive economies of scale enable him to raise pigs substantially cheaper than other producers. On



WHO'S OUT, WHO'S IN

With Koogle gone, Yahoo is banking on Old Economy exec Terry Semel, late of Warner Bros., to find new revenue sources

INSIDERS!

The untold story of how arrogance, infighting, and management missteps derailed one of the hottest companies on the Web

BY BEN ELGIN

The first sign that the game had changed for Yahoo! Inc. came just days after its stock hit an all-time high—of \$237.50. On Friday, Jan. 7, 2000, when Yahoo's staff was winding down for the weekend, a phone call came in to the third-floor executive cubicles. On the other line: an investment banker with a juicy tip that chief rival America Online Inc. was about to buy old-media

at Time Warner Inc., a deal that ultimately went through for \$85 billion in stock. The move would rearrange the plan in the media universe—and rock Yahoo's world.

The next morning, CEO Timothy A. Koogle, President Jeffrey Mallett, and co-founder Jerry Yang held a council of in a purple-and-yellow conference room at the company's Santa Clara (Calif.) headquarters. Should Yahoo

stick to its guns and remain an independent assembler of news and entertainment supplied by others? Or should it take advantage of its \$110 billion market cap to

make an old-media purchase of its own? Koogle favored staying the course, saying Yahoo had a better chance of lining up quality content if it teamed with all comers instead of buying one big media company. Mallett said later that he was "torn."

After four hours, a pot of Koogle's bitter coffee, and umpteen squiggles on the white board, the trio reached consensus: They would not follow AOL's lead. All of Yahoo's chips would remain on the Net.

It was Yahoo's first big mistake—and a presage of what was to come. Over the next 13 months, Yahoo's

management troika, the "Three Amigos," would commit a series of blunders that would downgrade the No.1 Internet portal from powerhouse to Milquetoast. Corner-office intrigue, consensus management in gridlock, a souring economy, and plain old bad judgment would conspire to send Yahoo's revenues plummeting 42% in the most recent quarter, to \$180 million. Yahoo's market cap is \$11 billion, down 92% from its high. The company has ordered its first-ever layoff—some 400 people. And 3,100 remaining workers are saying good-bye to Koogle, their longtime leader, who was pushed out two months ago.

Worse yet, Yahoo's problems can't be fixed by a little cost-snipping and an upsurge in the economy. Its reliance on advertising revenues has turned into a liability as dot-com advertisers die off like mayflies and corporate advertisers pony up 50% less for online ads than they did a year ago. Meanwhile, AOL Time Warner boasts a \$221 billion market cap and controls a vast empire of online properties, magazines, movie studios, and book publishers. Its advertising and commerce revenues rose 10% last quarter.

Today, Yahoo's fate rests with Terry S. Semel, the former co-CEO of Warner Bros. who took over on May 1. He has set aside 60 days to figure out what to do. Then, analysts say, he'll shake things up. Semel is considering bringing in a couple of lieutenants from his Tinseltown days, including James Moloshok, an ex-Warner Bros. man, says an executive close to the discussions. The new team's job is twofold: to convince advertisers Yahoo can deliver a solid return for their money and to reduce Yahoo's dependence on those ad dollars. Semel is likely to speed up forays into newer sources of revenue—including its premium subscription services for consumers. Analysts are looking for nonadvertising revenues to increase from 10% of the total last year to about 25% in 2002.

Semel is betting heavily that he can turn the company around. In an unusual move, he plunked down more than \$17 million of his own money to buy 1 million shares of the com-



ILLUSTRATION BY ALAN LEVENSON

pany's stock. Moreover, he signed an equity-heavy package that gives him just \$300,000 in salary. Many of his stock options are priced at or above the price when he joined. So he must make dramatic improvements to collect on his bet. "I have a strong conviction about Yahoo's ability to leverage its core assets into a successful global company," he said after being appointed to the job.

Can Semel do it? It's a long shot. As a 21-year Warner Bros. veteran who left Time Warner in 1999, he earns kudos for running the movie business, where he was responsible for megahits such as the *Lethal Weapon* series. But Semel failed to deliver when his duties were expanded to include Time Warner's music and amusement-park businesses. He didn't turn the company's Web sites into moneymakers. And he has little experience with advertising. "Semel's not a turn-around expert. And he doesn't know how to sell to large advertisers," says analyst Scott Reamer of SG Cowen Securities Corp. Semel responds that he has extensive experience running a media company, and that's what matters.

Semel's most daunting challenge will be rebuilding Yahoo's dysfunctional management team. In a surprise move, Koogle was pushed out of his CEO job on Feb. 27 by the board of directors, who also passed over Mallett to seek a CEO from outside. Insiders say Koogle had taken a 30,000-foot view: He acted as chief visionary, distancing himself from operational chores and losing touch with the market. He misjudged how badly the dot-com implosion would hurt the company.

At the same time, Mallett, who was running daily operations, was angling for the CEO job. An operations whiz, he was growing more frustrated with Koogle's consensus-style management and his lack of involvement. "He felt like he was dog-paddling with one arm tied behind his back," says a former Yahoo executive. Mallett, 36, began telling people he would "move up" shortly, says a job candidate who talked to him. And seasoned execs, who could challenge Mallett's influence, were blocked from critical roles. Tension mounted between Mallett and Koogle. What seemed on paper a good match—of a big-picture CEO and a nuts-and-bolts president—turned into a toxic brew.

Emerging from the melee stronger than ever is co-founder and board member Jerry Yang. While Yahoo's "professional"



JERRY YANG

managers, Koogle and Mallett, were blamed for Yahoo's slip-ups. Yang's image as Yahoo's goodwill ambassador has shielded him from criticism. He also has the ear of Masayoshi Son, CEO of Softbank Corp., which owns 21% of Yahoo's stock and has a representative on the board. Yang, along with board member Michael J. Moritz, a grizzled venture capitalist at Sequoia Capital who was Yahoo's first backer, spearheaded the decision to replace Koogle and pass over Mallett, say insiders and several outside sources close to the board. They then orchestrated the hiring of Yang's buddy, Semel.

Yang, Koogle, and Mallett were precisely the ones who led Yahoo to its early success. In less than six years, they transformed the company from a simple directory of Web sites to the best-known brand on the Web, with \$1 billion in annual revenues and more than 190 million monthly visitors worldwide. At its peak, on Jan. 3, 2000, the company's market cap was \$16 billion, more than twice that of media giant Walt Disney Co.

Now, Semel must find a way to restore Yahoo to its former stature. To grasp just how difficult that will be, it's important

The co-founder has emerged from the fire stronger than ever

YAHOO'S SUDDEN FALL FROM THE PINNACLE

JAN. 3, 2000 Yahoo stock closed at an all-time high of a split-adjusted \$237.50.

JAN. 8, 2000 Yahoo's top execs powwowed after learning that rival America Online would acquire media giant Time Warner. Should they do something similar? Yahoo's answer: No.



MARCH, 2000

Yahoo flirted with buying auction site eBay. CEO Tim Koogle was for it,

but talks crumbled when No. 2 Yahoo exec Jeff Mallett banded with co-founders Jerry Yang and David Filo to oppose the deal.

SUMMER, 2000 Complaints of Yahoo's arrogance mounted. In a meeting with ad agency OgilvyInteractive, Yahoo execs showed no interest in a strategic relationship.

OCT. 10, 2000 Attempting to quell concerns about its

ad revenues, Yahoo said 40% of its business came from dot-coms, down from 47% the previous quarter.



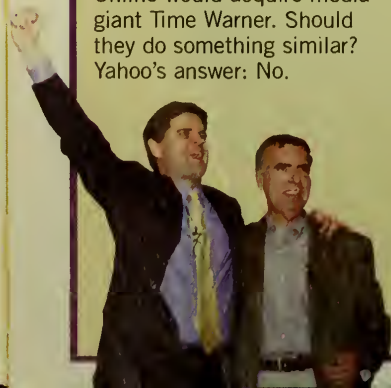
NOV. 21, 2000

Net cheerleader and Morgan Stanley analyst Mary Meeker downgraded

Yahoo's stock to "outperform" because of ad worries. Stock plunged 15%, to \$41.69.

NOVEMBER, 2000 Yahoo's board first considered a management shakeup. With Yahoo on the verge of topping \$1 billion in sales for 2000, the idea was rejected.

JAN. 10, 2001 Despite notching up record sales of \$311 million for the quarter, Yahoo slashed its forecast for the next quarter by 25%, to \$230 million.





MICHAEL MORITZ



JEFF MALLETT

understand how the upstart ran und. Koogle and Moritz would comment for this story, and g, Mallett, and Semel would only about the company's business prospects. But through views with 20 current and former executives and well-ed sources outside the company, *BusinessWeek* has re-structured Yahoo's slide. Here, for the first time, is the inside y behind Yahoo's meltdown:

Along with Yang, the VC led the effort to oust Koogle

TAKE NO. 2

than three months after Yahoo balked at an old-media isition, it got a second chance to alter its fate. Again, it

blew it. Seeking to beef up its e-commerce revenues, Yahoo began negotiating to buy Web auction leader eBay Inc. in late March, 2000. But as acquisition talks heated up, so did Yahoo's internal politics. Koogle wanted the deal. But Mallett was concerned about having eBay CEO Margaret C. Whitman in Yahoo's executive lineup, say eBay insiders. Whitman wanted to report directly to Koogle, say the insiders, while Mallett insisted that eBay's CEO report through him. Koogle and Mallett also differed on the strategic importance of the deal. "Tim could see the wisdom of challenging the Yahoo culture through a deal with eBay. Others were more threatened," says Robert C. Kagle, a venture capitalist on eBay's board.

With the deal looming, Mallett went on the offensive, according to sources close to the negotiations. He appealed to co-founders Yang and David Filo, trying to convince them that the eBay culture would be a poor fit for Yahoo. Soon, both founders were in his camp. Filo sent an e-mail to Koogle, urging him to back away from the deal. "The whole thing got very dysfunctional. They were clashing," says a source close to the negotiations. With Koogle outnumbered, the potential deal unraveled. "This was Yahoo's most fundamental problem. It was always management by persuasion, not management by dictation," says former Yahoo manager Rich Rygg.

And Yahoo paid for it. While Yahoo's fortunes have flagged,

He felt frustrated by Koogle's distance from daily operations

pany blamed an ad l.

Y, 2001 The idea of ement overhaul was in floated at a board This time it got a consideration. But was taken.

.5%



FEB. 15, 2001 Within two days, Fabiola Arredondo, head of Yahoo Europe, and Savio Chow, Yahoo's Asia chief, resigned. Days later, Jin Youm, CEO in Korea, quit. All cited personal reasons.

FEB. 27, 2001

With ad revenues declining sharply, Yahoo's board replaced Koogle. Mallett would not be moved up. Koogle called headhunter Jim Citrin and asked him to search for a replacement.



MAR. 7, 2001 Addressing the staff, Koogle announced he would give up the CEO post. Co-founder Jerry Yang shed tears. Hours later, the news was made public.

APR. 6, 2001 Yahoo's board voted unanimously to offer the top job to former Warner Bros. Chairman and co-CEO Terry Semel.

APR. 11, 2001 Yahoo announced disappointing first-quarter sales of \$180 million, down 42% from the prior quarter. On the same day, Heather Killen, head of international operations, resigned.

APR. 17, 2001 Semel was named Yahoo's new boss. He agreed to take the job after Koogle also threw in the chairmanship.

MAY 1, 2001 Semel began work as Yahoo's new CEO and set aside 60 days to immerse himself in the business before he would lay out a turnaround plan.

(TOP, L TO R) ANDY FREEBERG, RICHARD MORGENTHAU, ROBERT CARDIN (BOTTOM, L TO R) MIKE SEGAR/REUTERS, ALAN LEVISON, ANDREW BRUSSO, RICHARD DREW/AP, DPA, MARC BRYAN-BROWN

Yahoo's take-the-money-and-run style prevented it from spotting fundamental changes in the Net ad market

eBay has emerged as a rare dot-com success story. In the first quarter, eBay's revenues jumped 79%, to \$184 million, and its net income hit \$21 million. If the merger had gone through, Yahoo would no longer have to rely on advertising for 90% of its revenues, and rather than losing \$11 million last quarter, it would be profitable.

TURNING A BLIND EYE

How could things like this happen? Call it the arrogance of success. The Three Amigos felt invincible and had little incentive to seek talent or advice from outside their brain trust. Seemingly with good reason. While other ad-supported sites began to struggle with the slowdown in dot-com budgets, Yahoo blew past revenue estimates quarter after quarter. A leading Web property such as Yahoo, it appeared, could withstand just about any shellacking to the Web advertising market.

The company made no special effort to make traditional advertisers see the value of creating a presence online. It was accustomed to getting the rates it asked for, cutting a deal, and then moving on. "We ran Yahoo to optimize market share. I make no apologies for that," Mallett said in a January interview. "If there was a company that didn't get it [Internet advertising], we moved on very quickly."

Even big potential clients got the brush-off. Consider OgilvyInteractive, which handles online media buying for mammoth customers such as IBM. They held a meeting with Yahoo in early 2000 to explore an advertising relationship. The Ogilvy executives, however, were more interested in buying some advertising six months out, instead of right away. So the relationship disintegrated. "They were more interested in the here and now," says Jeannette McClelland, president of OgilvyInteractive North America. She notes, however, that Yahoo has become more accommodating in recent months.

Yahoo's take-the-money-and-run style, along with its dearth of media veterans, prevented it from spotting fundamental changes in the Net advertising market. As the summer of 2000 wore on, the biggest traditional advertisers began looking for online marketing ideas beyond Yahoo's banner ads, which elicited less and less interest from consumers—even as Yahoo's audience continued to grow. These corporations wanted ad campaigns integrating the Inter-

net, TV, and radio. The soon-to-be-merged AOL Time Warner could offer that. Not Yahoo.

EARTH TO YAHOO

It was Monday morning, Oct. 23, when Yahoo took its first serious look in the mirror. At a retreat in California's Yosemite National Park for Yahoo's top brass and managers, Mallett took the stage and prodded the several hundred attendees to change the way they did business. Yahoo needed to treat advertisers and business partners better. "It was just w-

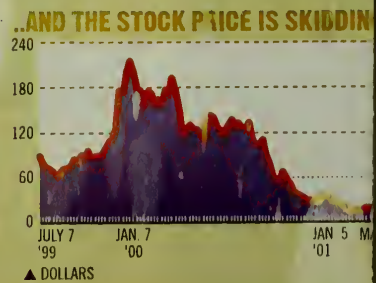
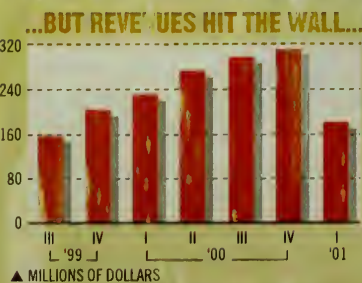
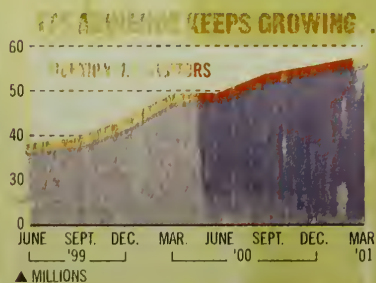
MEET THE BOARD

- ☑ **TERRY SEMEL** The longtime Warner Bros. executive started as Yahoo's chairman and CEO on May 1.
- ☑ **TIMOTHY KOOGLER** Yahoo's chairman and CEO for more than five years, until plummeting ad sales cost him his job.
- ☑ **JERRY YANG** The co-founder and Chief Yahoo played a leading role in the changing of the guard.
- ☑ **MICHAEL MORITZ** This veteran venture capitalist at Sequoia Capital helped fund Yahoo in its early days and then helped find Koogle's replacement.
- ☑ **JEFFREY MALLET** Yahoo's president wanted the CEO job but got passed over when the change came.
- ☑ **ERIC HIPPEAU** The former Ziff-Davis CEO represents Softbank Corp., an early investor that owns 21% of Yahoo.
- ☑ **ARTHUR KERN** Chairman of American Media, which holds stakes in media companies. Joined in 1996.
- ☑ **EDWARD KOZEL** A former Cisco Systems exec who is a venture capitalist with Open Range Ventures. Joined in 2000.

everyone needed to hear," says one former exec who tended the powwow. Problem was, many of the managers didn't take the message seriously. "The business-development people all had smirks on their faces," recalls the executive. "Then the ideas never got reinforced."

That complacency didn't last long. Yahoo salespeople started noticing that advertisers weren't willing to pay the s-

YAHOO'S UPS AND DOWNS



Data: Jupiter Media Metrix, Bloomberg Financial Markets

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After analyst Mary Meeker downgraded the stock, Yahoo execs landed on the hot seat

rates for banner ads. The real wake-up call came on Nov. 21. Longtime Yahoo cheerleader and Morgan Stanley Dean Witter analyst Mary Meeker issued a report that punctured the company's prospects. She downgraded Yahoo's stock from "buy" to "outperform" and advised it to beef up its executive ranks. Yahoo's stock plunged 15% in a day.

Yahoo execs were furious. The hyperkinetic Mallett fumed for about 10 minutes, he said later. Then he read the report again. Slowly it started to sink in. On most fronts, Meeker was dead-on. In fact, Yahoo was already working to address several of the criticisms. Within days, Mallett had pinned a copy of Meeker's report to his cubicle wall next to his children's artwork. On top of the report, Mallett stuck a note: "The market's tough, but we're tougher."

The company's board began to stir as well. Long chided by analysts for its insular nature, the seven-member board included Koogle, Mallett, and Yang, as well as backers Moritz and Eric Hippeau of Softbank. The only true outsiders: Arthur Kern, chairman of holding company American Media, and the recently appointed Edward Kozel, former executive at Cisco Systems Inc. Starting in November, the directors floated a number of ideas for strengthening Yahoo management. One possibility discussed: bringing in a new CEO. But with Yahoo closing in on \$1.1 billion in sales for 2000, nearly twice as much as in 1999, the idea gained little

traction. Instead, Yahoo stepped up its efforts to hire a new sales chief and brought in other traditional-media ex-

WINTER OF THEIR DISCONTENT

With the pressure on Yahoo's top execs rising fast, the storm started to show. For starters, tension was growing between Mallett and Koogle. A key friction point was Koogle's sensus-style management, which slowed decision-making. Koogle's pace, say former Yahoo execs. "Every time we went into a meeting, we'd ask, 'Is this going to be a T.K. [Koogle] meeting?' Or is this not going to be a T.K. meeting?" recalls a former exec. "We wanted to know if we were actually going to get anything done." According to this former Yahoo exec, it began to wear on Mallett. "He insisted he knew how to fix Yahoo but was frustrated by [Koogle's] lack of involvement and the consensus-driven management," the source says. On the flip side, the former executive says: "Koogle thought that if Mallett knew how to fix things at Yahoo, he would have already done it."

Mallett was coveting the CEO job, say insiders. One of the candidates for Yahoo's top sales job recalls that during a January interview, Mallett made it clear that he was planning to "move up" shortly. He also continued to protect his position fiercely. Shortly after Yahoo polished off its acquisition of community site eGroups Inc. in August, Koogle and eGroups

CEO Michael Klein were seen chumming around the office and appeared to be hitting it off with current and former Yahoo execs. "From that point on, it was like [Klein] had a black eye painted on his forehead," says a former Yahoo executive. Later, Klein was put in a nonoperating role. A Yahoo spokesman says Mallett did not try to promote his own interests at the expense of others: "If someone is the right fit for Yahoo and its business, the management team is absolutely supportive of that role and success in the company."

By January, the board was focused on leadership. Ad sales were weakening. In January 10, the company was forced to slash its forecast for the upcoming first quarter by 25%, to \$230 million. Publicly, Yahoo blamed general market conditions and was moving away from dot-com advertisers. In reality, the board was looking closely at Yahoo's missteps and its struggling management team. In January and February, Yahoo directors battled around ideas. Koogle floated the idea of his stepping down, say insiders. And directors discussed bringing in someone above Mallett or bolstering the vice-presidential ranks, say insiders.

Then things got worse. Ad sales dropped quickly that Yahoo eventually had to slash its first-quarter forecast by an additional 25%, to \$175 million. Equally bad, Yahoo began losing international executives at a frightening pace. On Feb. 15, Euro chief Fabiola Arredondo announced her resignation. A day later, the director of Yahoo Asia, Savio Chow, stepped down. W

CEO SEMEL'S TO-DO LIST

SHORE UP ADVERTISING During its go-go years, Yahoo alienated advertisers by dictating terms. Now Yahoo must woo them by promising more bang for their buck, such as charging only when users click on an ad or make a purchase from the advertiser. This is going to be tough for new CEO Terry Semel, who has little experience selling ads to big businesses.

REBUILD MANAGEMENT Yahoo has lost 10 top execs in a matter of months. Semel is expected to bring in his own lieutenants, which could prompt Yahoo President Jeffrey Mallett to leave. Semel has the tricky task of rebuilding management while keeping the loyalty of employees.

MAKE CUSTOMERS PAY Semel has more than 20 years' experience selling entertainment to consumers. But doing it on the Internet is tricky. Most people don't have Net connections speedy enough to watch film clips or listen to live broadcasts—experiences Yahoo could charge for. Semel needs to come up with services that satisfy at slow access speeds.

BUILD A CORPORATE BUSINESS Yahoo is selling custom-made Web sites and Internet conferencing services to other companies. This is expected to rack up \$155 million this year. But will Yahoo, the consummate consumer brand, appeal to enough businesses? Already, cash-strapped Yahoo has been forced to postpone an ad blitz touting its corporate offerings.

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zil and a pad. The dual hinge LCD screen lets you use it
or upright. But, unlike a pad, this Pen Tablet also lets you
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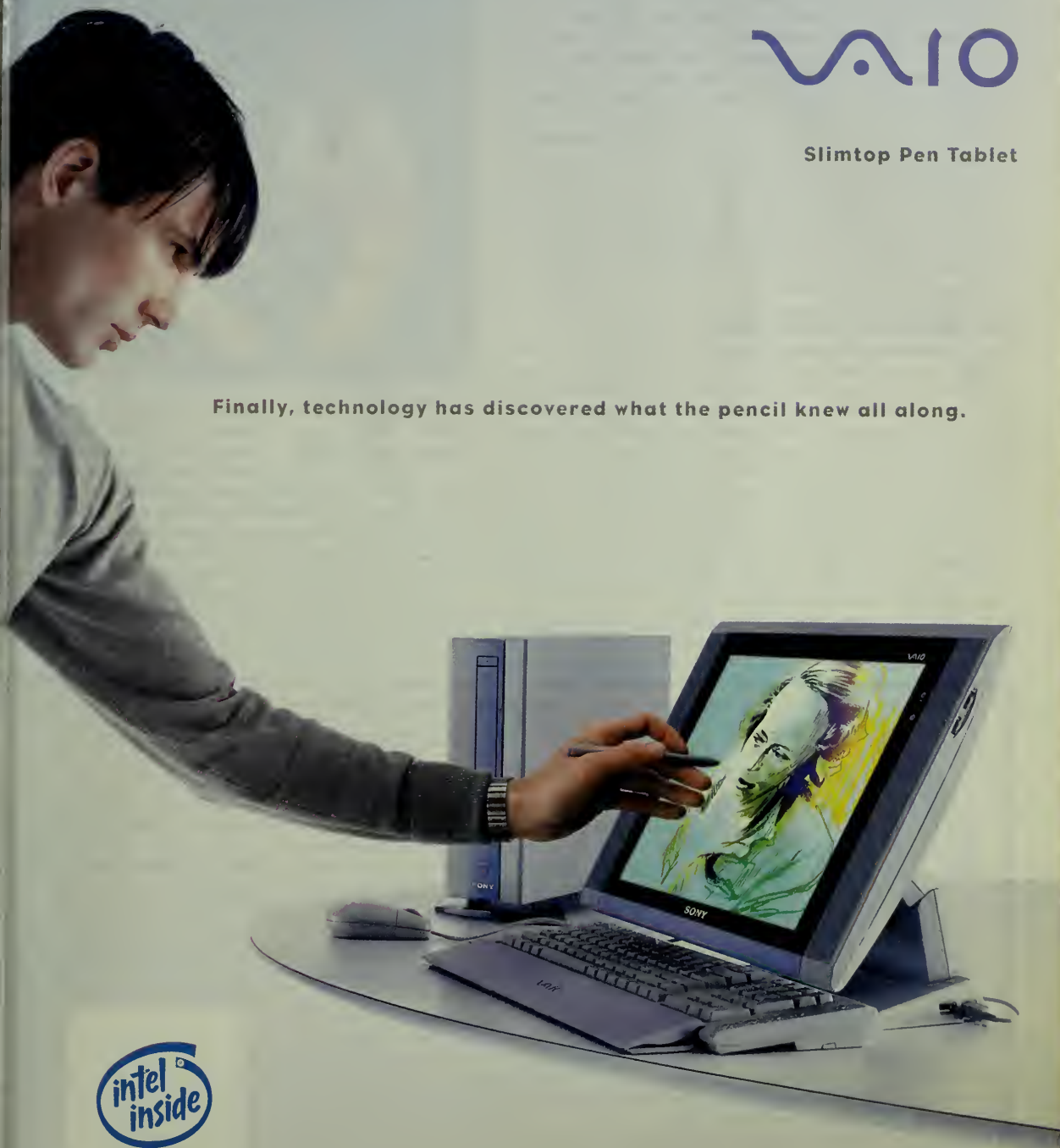
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Koogle favored a deal to buy eBay last y

weeks, six international executives left the company. Heavy-handed control from Yahoo headquarters left some overseas execs irked, say two former international managers. All of the former international execs declined to comment.

By the time of the Feb. 27 board meeting, the directors had seen enough. With Moritz and Yang leading the discussion, the board came to a verdict: Koogle would step down as CEO but could remain on as chairman. And Mallett would not be considered to replace Koogle. "Mallett was generally viewed as not being ready for the job," says a source close to the board.

Koogle took the decision calmly. "He was well aware of his shortcomings," says a source close to the company. "He blamed himself for not keeping a closer eye on Mallett. Koogle also felt that his lack of media experience had hurt the company." At 10 o'clock that night, Koogle put in a telephone call to a CEO recruiter to begin the search for his replacement. The most critical leg of Yahoo's management overhaul was about to begin.

DOC HOLLYWOOD TO THE RESCUE

One candidate quickly rose to the top of the CEO-search list. In the two days following the fateful board meeting, several directors secretly gathered at Yahoo's headquarters with Spencer Stuart recruiter Jim Citrin. The agenda: brainstorming on what they wanted in a new leader and floating the names of possible candidates. Yang was pushing for Semel. They had met at a 1999 media conference in Idaho. Since then, the two had forged a friendship, meeting for lunch every two months or so. Adding to the allure, Semel is a friend of Gordy Crawford, a partner in Capital Research & Management, which owns a 6% stake in Yahoo.

Yahoo was interested, but was Semel? After all, the 53-year-old had retired from Warner Bros. a multimillionaire in late 1999. Since then, he had been investing in online entertainment companies with his own company, Windsor Media Inc. Yang and Semel met for lunch on Mar. 9 in one of Ya-



Filo with the "Three Amigos": Yang, Koogle, and Mallett

the CEO job. Semel said he was intrigued.

It was time for serious talks. Semel met with members of Yahoo's board. He squeezed in an hourlong meeting with Mallett. That started out uncomfortably, according to a source close to the board, but then Semel suggested that they talk about their lives outside of work. Even though Mallett was bitterly disappointed about being passed over, he was charmed by Semel, say two sources close to Yahoo's board. Semel's candidacy was picking up steam.

hoo's conference rooms. Yang quickly brought Semel up to speed on the leadership change and asked if he was interested in the CEO job.

WEB-SITE REVIEW

By Timothy J. Mullaney

HOW YAHOO GOT SO HO-HUM

I'll never forget the day I met Yahoo! President Jeffrey A. Mallett. Probably a dozen *BusinessWeek* editors crowded into a room like so many college kids waiting for a chance to see the Beatles. Such a picture he painted: Voice over the Web will take off in 2000. Yahoo will help people pay their bills online. The company will revolutionize direct selling with a huge consumer-preference database. And so on. We editors ate it up. We did everything but stand outside his hotel and scream.

But instead of *Baby, You're a Rich Man*, Yahoo's plans have produced *A Hard Day's Night*. Yahoo.com looks an awful lot like it did in 1999. And that's the problem. Yahoo set the standard for Web portals—with clean layout, information from all over the Web organized

in handy directories, and a MyYahoo! feature that lets you personalize news and other information on your screen. But nothing has been added since 1999 that's nearly as fresh.

GRINDINGLY DULL. In fact, too much that Yahoo has done since has been mediocre or me-too. Its 1999 purchase of GeoCities brought tens of thousands of personal Web sites that are simply too boring to make either good content or good business. The Broadcast.com deal brings TV online, but Yahoo's programming is uninspired. The portal has auctions and instant messaging, but so does everybody else. And its new subscription services don't deliver distinctive value or offer Yahoo a competitive advantage.

Take GeoCities. I looked at more than 100 GeoCities pages and wouldn't visit

any of them again. Why? For sure, the basic page is pretty limited, with sites for unsigned bands, for example, there isn't enough server space to offer downloadable tunes or video clips. But there is room for features of the Massachusetts bar Ace*Hole giving the camera the Charming. Site after site is as dull as your pal's vacation slides.

Yahoo! Broadcast, née Broadcast.com, may be even more disappointing the day I write this, its features include a hockey game, a basketball game, and an interview with a Asner; respectively, one on ESPN on TNT, and one so boring I won't watch it. There are two problems with consumer Webcasting: a shortage of interesting content not already p-

Mallett balked, killing the idea

By the time of a board teleconference on Apr. 6, the Yahoo directors were sold. Director Moritz, who headed the board's search committee, went around to all participants in the phone call, asking for their thoughts about Semel. Although Semel wasn't steeped in advertising experience, he knew how to manage a fast-growing company. He had helped build Warner Bros. from \$1 billion to more than \$11 billion. The vote was unanimous: Semel was to be offered the CEO job.

But the drama wasn't over. On Apr. 8, Moritz and Yang flew to Los Angeles, rented a car, and sped out to Semel's house in Bel Air. After pitching their offer to Semel, Moritz and Yang walked through the details of the contract—including the fact that they wanted to pay only \$300,000 in salary, offering a large option package instead. Semel was interested, but a few stumbling blocks emerged. One biggie: Koogle's role as chairman. "Semel was worried about following a legendary CEO who still had the affection of his employees," says

source close to the board. "It wasn't an ego thing. It was making it perfectly clear who was in charge."

Just a month earlier, the popular Koogle had promised Semel's employees that he would remain as chairman. Relinquishing the title would all but sever his daily contact with the company he had run since 1995. But there was little guilt: Koogle would have to part with the chairman or Semel would probably walk. Several days after the \$8 job offer, Koogle threw in the chairman title, say insiders. "I'm glad it didn't come to a head. It could have been a deal killer," says an insider. Koogle stayed on the board of directors with the title of vice-chairman.

On May 1, Koogle's era came to a close. Some of the 49-

year-old exec's allies say he has long been ready to ratchet back his lifestyle and pursue his myriad interests, from racing his Mercedes convertible to hobnobbing with artists in Italy. Indeed, it seems as if his moment has passed. The youthful enthusiasm and experimentation of the early days of the Net has been replaced by a brass-tacks management style to which he's ill-suited. "He was extremely gentlemanly and, in a way, very unbusinesslike," says Adriano Berengo, an Italian glassblower and Koogle friend.

YAHOO'S FUTURE

It's not clear if Mallett has a future at Yahoo, either. Although Semel and Mallett insist he'll remain, there's a question whether he'll stay on for very long after the transition is complete. If Semel brings in his former Warner Bros. lieutenants, that could speed Mallett's departure. "Mallett will be gone," says analyst Andrea Rice of Deutsche Bank Alex. Brown. "It was assumed that at some point the mantle would be passed to him. Now there's no reason to stay." Sure, Mallett knows the inner workings of Yahoo's business better than anyone else and boasts a loyal following among employees. But he's also partly responsible for the hubris that damaged Yahoo with so many partners and advertisers—the very past from which Semel will want a clean break.

Together, Koogle and Mallett will be remembered as the management duo that built Yahoo into one of the mightiest Internet companies. But the bad mix of Koogle's disengagement and Mallett's headstrong ways kept them from anticipating vital adjustments, and this left the company vulnerable when Yahoo's world began to spin out of control. Is the company that Koogle and Mallett helped build a long-term business or will Yahoo be the ultimate example of blown opportunities during the Web's glory days? The answer to that question is now in Semel's hands.

With Linda Himmelstein in San Mateo, Calif., Ronald Grover in Los Angeles, and Heather Green in New York

radio and a shortage of bandwidth to provide streaming-video content. Even if you have a computer available, you're probably near a TV, and if I'm near a TV, I'm not watching a National Basketball Association game online, ever. Web pages improve Yahoo's news and search. But most of its video

clips are a few seconds or perhaps a minute or two long.

Yahoo's paid services look like another bust. Online bill-paying doesn't seem promising. Banks bundle bill-paying services with their computer banking. Brokerages bundle into trading commissions the real-time stock quotes and

alerts Yahoo would like people to pay \$9.95 a month for.

It's hard to see where Yahoo's edge is going to come from. A music-downloading service is coming this summer, but it'll be tough to catch up with America Online, which has the well-regarded Spinner music channel and is

building synergies with its new Time Warner divisions.

Over the years, Yahoo followers spent a lot of time debating whether Yahoo was a technology company or a media company. But since 1999, it hasn't been great at being either. AOL has stepped up from where it was in 1999. Yahoo hasn't.

Mullaney writes the Clicks & Misses column for BusinessWeek e.biz.

HITTING THE CEILING

WHAT WORKS

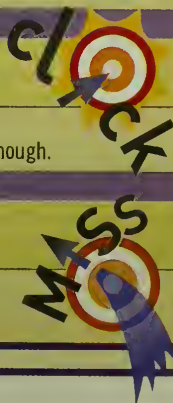
FINANCE Still one of the most popular finance sites. But lots of people have lost its strong points, and its chat rooms are crowded with obnoxious participants.

YAHOO This personalization capability is easy to set up—listing your stocks, your age, and the types of news you're interested in. Most rivals have their own versions, though.

WHAT NEEDS WORK

PAGES Added thousands of individual Web pages. It's fun for folks who love them and their loved ones, but a bore for many of the rest of us.

BROADCAST Offers up sports and news videos that are readily available on TV. The music-download section gets blown away by AOL, MP3.com, and Napster.



DON'T JUST ANALYZE THE MARKET, ANALYZE THE INVESTOR

"Behaviorist" fund managers make hay by studying quirky sentiments

The market is one big head case. After the tear and tumble of Internet stocks, who can deny how intensely the power of suggestion works on investors? They're seduced by the markets, from tulips to technology. Seasons and days of the week sway them to buy or sell a stock. Academics have come up with a slew of diagnoses to explain their neuroses. And from that, a new breed of money manager has emerged—one who capitalizes on investor quirks.

"I can't outguess Warren Buffett, but I can stay one step ahead of the American multitudes," says Harvard University's Richard J. Zeckhauser, a behavioral economist who runs seminars on the topic. "Stock patterns emerge from common human behavior."

Wall Street traditionalists bank their bucks on such market data as earnings estimates, price-earnings ratios, and revenue growth. They subscribe to theories that say markets behave efficiently. Not so, say behavioral economists, whose ideas gained credibility in the 1990s. They maintain that the emotional baggage of investors can make markets go haywire, though reality eventually sets in. The ability to spot irra-

tionality allows these managers to profit from market imperfections, betting that investors will return to their senses. And there's a lot investors can learn from these pros about how to keep their

heads straight when invest

One example of fear overpowering son: Think back to November when the tech sell-off began. Prospects for the future looked bleak, and stocks like Buy Inc. got hit. It fell to \$22 from \$30. That was a buy signal for behavioral manager David Dreman, chief investment officer of Dreman Value Management LLC, who oversees \$5.7 billion. "You buy when solid companies get knocked down cheap," he says. Once investors saved error of their ways, they bid Best back up to a current \$53. The stars in the 48.6% one-year return for the Scudder-Dreman High Turn Fund.

ON AUTOPILOT. Behaviorists say investors tend to latch on to extremes, too. Down or up trends are etched in their minds as certainties, rather than mere probabilities. Take Cisco Systems. The stock zoomed for years, offering double-digit returns. Investors got used to it, and expected history to repeat itself. Last year, when the stock began to fall as evidence emerged that business was slowing, many investors went into denial, refusing to let go. "Investors have extrapolated Cisco's past performance far into the future," says Josef Laishch, chief investment officer of I.S. set Management. He is a behavioral finance professor at the University of Illinois who launched I.S.V. in 1994. Now manages \$7.5 billion for the likes of Caterpillar and Stanford.

Far too often, analysts—and invest



Irrational Notions

Mental traps that trip up investors

ANCHORS	DENIAL	HEROICS	HERD MENTALITY	BLINDERS	EXTREMISM
Fixing on price targets, such as "It's a \$200 stock," or Dow 36,000. Filtering out any news that undermines the target.	Refusing to sell a losing stock because it means admitting error and giving up hope.	Overestimating ability to pick stocks and understand the market. Minimizing failures and remembering successes.	Following the crowd rather than taking a more analytical view of the market or a stock.	Stereotyping stocks and companies as winners or losers, thereby missing reversals in a company's fortune.	Regarding improbable events as "impossible" and probable events as "certain"—simply misjudging risk.

follow them—exhibit “anchoring” behavior. They get attached to inaccurate targets and ignore evidence that might be wrong. One might say UBS/PaineWebber’s analyst Walter Wyck had a problem with anchoring: In December, 1999, Piecyk’s “buy” rating for Qualcomm Inc. caused the telecom stock to jump 30% in one day. At the time, the stock was trading at \$659, a week high. Piecyk held onto a \$1,000 target for months despite the fact that the company was having problems. After a 1-for-1 stock split, shares now trade at \$59, or a presplit price of \$236. “We’re for stocks where the analysts are anchored on their own prior forecasts overconfident in their ability to predict the future,” says Richard H. Thaler, a University of Chicago economist and partner at Fuller & Thaler Asset Management Inc., which manages \$1.4 billion. Thaler doesn’t forecast the market; he has never owned Qualcomm: “We try to forecast the errors of others.”

IRE SHOCK. Stereotyping a company makes investors think it can’t win. If a stock has been a dog for ages, they’re conditioned to expect the worst and miss the upside. Thaler’s \$140 million Behavioral Growth Fund buys companies that the market “underreacts.” One of its top 10 holdings, Oakley Inc., which makes athletic wear, is in the portfolio for an average cost of \$11. While it languished for a while, new footwear lines and eyeglass designs eventually improved the bottom line. Earnings were double last year’s 2000 estimates. “This company had a number of years ago, and it was hardwired into investors’ heads,” says the fund manager Fred Stanske. “It came back from the dead.” Once investors got the picture, they bid up the stock, doubling Stanske’s investment.

Unlike Thaler, some behaviorists look at the big picture. Consultant Woody Dorsey, who counts Fidelity Investments among his clients, gauges investor reactions to macro events: a fall in interest rates or joblessness and earnings reports. Take Investors have reacted far too rationally to Fed Chairman Alan Greenspan’s rate cuts and are still too high in love with stocks. The market has not digested imminent threats of inflation and energy shocks. Once the onset of a market—within a year—stocks will bubble. “We need to get to the opposite extreme of the bubble,” says Dorsey, because market fundamentals start to turn. “It’s those last chapters [of the bear market] that always look worst.” If Dorsey is right—and that’s a big “if”—level-headed investors should stay on the sidelines and wait for the real opportunity.

Mara Der Hovanesian in New York

COMMENTARY

By Emily Thornton

THE PERILS OF GOING ‘WHERE THE MONEY IS’

David Walsh’s \$100 million fortune has long been the object of Wall Street’s desire. For years, the president and chief operating officer of telecom company Global Crossing Ltd. kept a Prudential Securities Inc. account but resisted brokers’ pitches to handle all of his money. Then, when the market began to crater last spring, he changed his mind. Now, Walsh relies on Merrill Lynch

But the dive for cash is turning into a Darwinian struggle. Lehman Brothers, Merrill, Morgan Stanley, and others are all shooting for clients with \$10 million or more to invest. It’s not hard to fathom why. “It is one and a half times more profitable to serve the very high end of the wealth market,” says Maria Elena Lagomasino, co-head of J.P. Morgan Chase & Co.’s private bank.



TINY POOL Lehman, Morgan, Merrill, and others are aiming for clients with \$10 million to invest—just 92,000 households

HIGH LIFE: A SCENE FROM MY MAN GODFREY (1936)

& Co. for advice on everything from taxes to hedging products designed to help preserve his wealth. “The more wealth you create, the more risk you have,” says Walsh.

That’s music to Wall Street’s ears. With traditional money-spinners such as initial public offerings and mergers in the doldrums, banks and brokerages are desperate to bolster falling revenues. With Willie Sutton-style logic, they’re going where the money is, scrambling to offer profitable fee-based wealth-advisory and management services to multimillionaires like Walsh. It makes sense: A mere 6% of households controls 60% of the nation’s \$18.6 trillion in investable assets, according to Chicago consultant Spectrem Group.

Trouble is, just 92,000 households have \$10 million in liquid assets, says researcher VIP Forum. So there may not be enough to go around all of the firms now rolling out ambitious plans. Advising on such complex portfolios is also a tricky market. Few private banks, traditional managers of old money, have carved out even a 5% share. “It’s getting very competitive,” says Rebecca Elrod, vice-president for private-client services at brokerage A.G. Edwards & Sons Inc.

TEAM PLAYERS? Wall Street will need to change its culture. Brokers have mostly worked alone on commission. Now, they are being hastily retrained

as team players earning fees. Morgan, Merrill, UBS PaineWebber, and Prudential are all reorganizing their brokers into teams to handle larger portfolios. This rush to suck up to the rich could lead to lesser service for those who don’t qualify. J.P. Morgan Chase now focuses on advising clients with \$25 million to invest, shelving recent plans to reach out to more mere millionaires. Lower down the scale, both Morgan Stanley and Merrill Lynch are looking for cheaper ways to service clients with less than \$100,000.

Catering to the super-rich may sound like a no-brainer. But it’s not going to be an easy sell.

Thornton covers investment banking.

IS ALLSTATE IN GOOD HANDS?

Ed Liddy is gunning the engine, but potholes loom

When Edward M. Liddy took over at Allstate Corp. in 1999, the insurance giant was so out of touch with the times that it didn't even have customer toll-free numbers. The Internet? It didn't have a clue about how to use it as a marketing tool. And some 40% of the outfit's agents were salaried employees, whose lackluster efforts were far outpaced by Allstate's own commission-driven independent agents—not to mention those of the independents who pitched policies for rivals. “You can't ignore the signs of change. My task was to understand where the marketplace was moving and get in front of that,” says the low-key CEO.

So Liddy, a turnaround artist who had reorganized the financial subsidiaries of Sears, Roebuck & Co. as chief financial officer, set to work giving the 70-year-old Allstate a makeover. He fired all 6,200 employee agents last year and offered them contracts to work as independents—which 3,800 accepted. He slashed an additional 4,000 jobs across the board, or 10% of the workforce, cutting costs by \$600 million, and channeled those savings into technology. He set up systems that let customers buy policies over the Net or by phone. And he began recasting the company from a plain-vanilla property-and-casualty insurer into a full-service financial-services provider that offers annuities, mutual funds, and even banking.

ROILED. But will it be enough? The hurdles are high. First, Liddy is going up against top-ranked State Farm Insurance, whose bargain-basement—and money-losing—rates are roiling the industry. Even Warren E. Buffett, who owns another rival, GEICO Corp., complains in his latest annual report that “the willingness of the largest player to tolerate such a cost makes the economics diffi-

cult for other participants.” As he diversifies, moreover, Liddy is competing with a bevy of other players—from Wall Street brokerages to banks—that can now sell insurance and lots more, thanks to financial-services deregulation. Making matters worse, he has to contend with legal headaches and morale problems born of his restructuring.

Those legal hassles are a big worry. Allstate, which had never seen layoffs as extensive as Liddy has engineered, is fighting lawsuits from dozens of former

employees. Even the Equal Employment Opportunity Commission may, after finding in September that the company violated federal laws when it sued employees to independent agents. The complaint contends that Allstate forced the agents into surrendering their rights when it asked them to sign waivers agreeing not to sue the company. Says an Allstate spokesman: “It is not uncommon that a major restructuring effort like Allstate has undertaken would result in litigation. Allstate worked very hard to make this transition as smooth as possible.”

IMPLACABLE? Such suits are corrosive morale just as Liddy is asking agents to master and cross-sell a broader array of financial-services products. “I can't imagine agents being excited about selling more products,” says Rod Guilmette, spokesman for the National Association of Professional State Agents Inc., a group that represents some of the agents that complained to the EEOC about the waivers.

But if he can placate the agents, Liddy's approach may have a fighting chance. It's already showing some signs of success. In the first quarter of this year, Allstate's new business was up 13% from the closing quarter of 2000. And Wall Street has applauded, hitting Allstate's stock 75% since the beginning of last year—a rise that has outpaced both the Standard & Poor's 500-stock

index and the S&P property-casualty index. The company's operating income in the first quarter rose 19%, to \$100 million, and money managers continue to be smitten with the stock. “People won't stop paying insurance [premiums] during a slowdown,” says A. La Thorndike, chief investment officer at Boston's Central Capital Management Inc., an Allstate shareholder.

Liddy's operational changes are bringing in business, too. The new phone centers are taking 1-800 calls from customers are logging sharp growth: In the first quarter, recorded an 85% increase in calls to 650,000, over the previous quarter, while online insurance sales are still in their infancy, the Internet

PLENTY OF NEW POLICIES

1 Some 6,200 agents have been eliminated from the payroll and transferred to contractor status

2 Insurance is now being sold over the Internet

3 The product line has expanded to include mutual funds and other investment vehicles

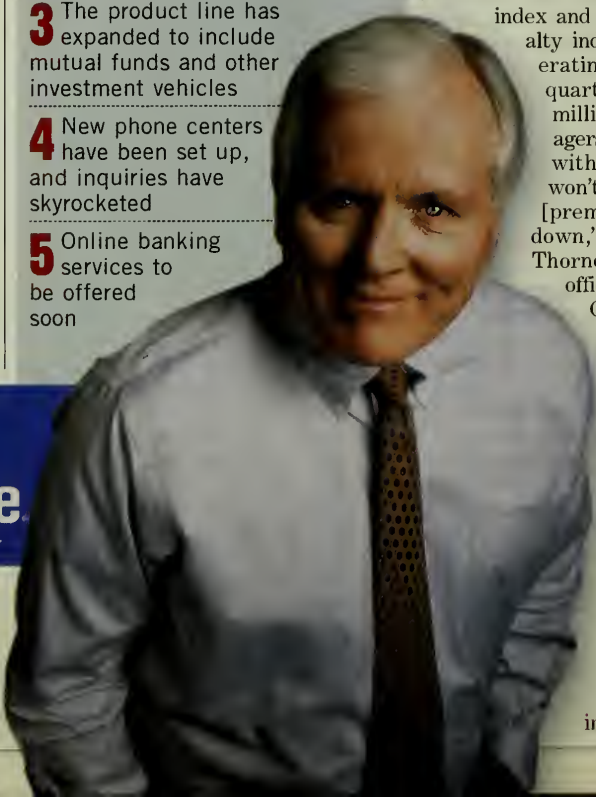
4 New phone centers have been set up, and inquiries have skyrocketed

5 Online banking services to be offered soon



Allstate
You're in good hands.

LIDDY: “My task was to understand where the marketplace was moving and get in front of that”



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expected to be the sales vehicle that clocks the fastest growth in the next two years. At the same time, sales of policies by agents are expected to decline 10%, according to New York's Insurance Information Institute.

BRANCHING WAY OUT. Allstate's potential for success as it diversifies into other financial service products is uncertain, considering how competitive the arena already is. But, its financial division's performance so far has been promising. Its revenue grew 20% last year, hitting \$4.8 billion, and accounting for 26% of Allstate's operating income, up from

18% in 1999. Agents can offer customers investment products such as annuities and are also able to sell mutual funds from the likes of Fidelity, Oppenheimer, and Van Kampen, among others. In addition, Allstate is awaiting Federal clearance to start a bank where consumers will be able to buy certificates of deposit and money-market accounts and apply for loans.

Still, Wall Street's confidence in the company may boil down to a belief in the CEO's record. Back when Liddy he was chief financial officer at Sears, he orchestrated a winning spin-off of Dean

Witter. In 1993, he helped take state public and oversaw the sale subsidiary Coldwell Banker Real estate Corp. from Sears. "Ed has participated in some major decisions involving tremendous change at Sears, he has a feel for how much an organization can take," says Philip J. Cell, CEO of Morgan Stanley Deanter & Co., who headed Dean Witter the early 1990s, working closely Liddy. If Allstate can manage changes Liddy is putting it through its future may be ensured.

By Pallavi Gogoi in Chicago

EQUITY

TAKING STOCK OF THEMSELVES

A wave of buybacks bodes well for the market

Stock buybacks are back. In April alone, tech companies announced programs worth \$7 billion, up from \$1 billion a year ago. In recent weeks, Oracle Corp. unveiled a \$3 billion program and Yahoo! Inc. one for \$500 million—its first ever. The binge isn't confined to tech companies, either: In May, publishers Readers' Digest Association Inc. and Knight Ridder Inc. both announced programs. And in the first quarter, nontech companies increased the amounts of shares they repurchased for the first time in a year.

What's going on? Companies have different motives for buying back their own shares. When employees exercise options, for example, earnings per share can quickly become diluted as the number of a company's shares outstanding grows. That worry prompted Yahoo's move. Sometimes a buyback is a sign that a company is very bullish about its own prospects. And with Nasdaq stocks down, on average, over 40% since last summer, companies can buy a lot more shares for fewer dollars, potentially giving a bigger boost to earnings per share. "I think management truly feels their stocks are undervalued. We haven't seen that conviction in the marketplace in a cou-

ple of years," says Goldman, Sachs & Co. Managing Director Peter Seibold.

That's certainly so at Readers' Digest. After peaking at \$41 in August, its shares now trade at around \$27, though operating profits rose 54% last year and 67% in 1999. On May 2, the board authorized the purchase of \$250 million worth of shares.

"At \$27, we think the company is still undervalued," says William Adler, a company spokesperson.

There's no guarantee that a stock buyback program will increase share prices. Last May, for instance, when CNET Networks Inc. announced a \$100 million buyback plan, its stock was trading at \$40, down from \$79 in December, 1999. Thus far, the company has spent \$30 million purchasing shares, and its stock has since slumped to \$12.

Some analysts consider the buyback trend alarming rather than encouraging. "It's a pretty powerful statement that during lean times companies are choosing to

spend money to repurchase shares rather than to grow the business," Jeffrey W. Joyce, senior associate at Consulting in New York.

CASH RICH. At times, management think of much else to do with surplus cash. That seems to be the case most savings and loans, especially National Central Bancshares Inc., a small savings and loan company in Fort Dodge, Iowa. It has announced buyback programs since 1996, purchasing over 50% of its outstanding shares. "Most of the S&Ls have so much excess capital that their No. 1 decision is much stock should they buy back," Jeff Gendell, general partner of York hedge fund Tontine Partners.

Few companies are that flush. But the optimists are right, the growing willingness to splurge on buybacks could help the stock market a lot in coming months.

By Debra Sparks in New York



BACK IN FASHION

Major stock buybacks announced since late April

COMPANY	AMOUNT MILLIONS
IBM	\$3,500
ORACLE	3,000
CIGNA	500
VERISIGN	350
READERS DIGEST	250

Data: The Online Investor



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Plowing the Net To Help Your Garden Grow

Dig around these Web sites before you get your hands dirty

BY LARRY ARMSTRONG

Every gardener, from the professional-for-hire to the weekend variety like me, knows the key to a spectacular summer backyard. No matter how much of the winter you spend poring over seed catalogs and plotting out your garden beds, come spring, you're going to have to get out there and start digging. Digging the holes to plant the plants, digging in the compost to help them grow, digging out the weeds that will inevitably try to take over.

But more and more, the first place gardeners start their digging is on the Internet. Maybe you're just looking for a quick answer to a simple question, such as what to do about aphids on rose bushes (pick them off by hand) or whether the crape myrtle you're eyeing will survive the winter on your New York balcony (probably not). Or perhaps you'd like to round out your growing collection of lavender with a rare white variety—something you're not likely to find at your local garden center, let alone at Wal-Mart Stores or Home Depot. Chances are you'll find a place to buy whatever you're looking for—or be able to trade someone for it—on the Web.

For novices, a good place to start is the National Gardening Assn. (nationalgardening.com). Besides offering general information and sections tailored to each region of the country, the site has a garden search engine, InfoDigger, that lets you comb a database of more than 18,000 frequently asked questions (FAQs), articles, and tips. It also gives free online courses that, because of a redesign, won't be back up until June 1. You may also want to check the short courses on annuals and perennials at www.burpee.com, the Web home of the famous seed company. They come complete with pop quizzes.

I like the volunteer-

maintained garden sites at about.com, suite101.com. While their contributors write regular columns on gardening issues, such as soil planting or pest control, they're most valuable for their links to other sites. If links are what you're

looking for, also check out backyardgardener.com, startingpage.com, or the garden links at Google's Web directory (directory.google.com).

Another good source of information is ahs.org, home page of the American Horticultural Society. For a membership, you'll need to take out a \$35 membership to get the details.

But if you're like me, you'll soon outgrow general sites. Most gardeners become smitten with certain types of plants. At specialized sites, you're bound to find someone like you, or better yet, someone more extreme who has turned a hobby into an obsession (or a business) and is happy to share their knowledge. My favorites are orchidlady.com and orchidspecies.com for orchids.

Gardening

Plants By Mail

CACTUS KING

cactusking.com

Vast selection of desert cacti and succulents; interesting living-succulent wreath

CAMP LOT A NOISE TROPICALS

clanorchids.com

Species and hybrid orchids; some other tropicals, including bromeliads

ETERA

etera.com

Sells fast-growing year-old perennials. Returns accepted. affiliated in garden centers

and cactus-mall.com and www.succulent-plant.com for cactuses.

Enthusiast organizations, such as the American Rose Society (ars.org) are particularly good for technical information, such as soil and growing conditions, common diseases and pest control. State agricultural universities are another good source of technical advice. They offer both general and scientific data and a local focus. Much of the information is regionalized to soil type and climate.

The best ones are Texas A&M University (aggie-horticulture.tamu.edu) and the Horticulture & Crop Sciences department at Ohio State University (hes.osu.edu). Both have extensive





ases of plant facts, and will search across some universities. OSU will also you pinpoint your state's agricultural resources. n't be afraid to use the message s and discussion groups that are of most Web sites. There, you can pose problems to amateur growers of the same es. I've found that by far the best are at enWeb (gardenweb.com), which runs more 100 single-topic message boards and has is in a half-dozen foreign languages.

better to ask specific questions: Don't just Help! My Japanese maple is dying." In- give all the details you can, such as "the are turning yellow and curling." Or "what o varieties do well in central Pennsylvania. Unlike the standard advice you get from facts and FAQs, you'll receive a variety of ers, usually based on real-life experience. Many forums, including GardenWeb, have and plant exchanges that provide an inex- ve way to try out unusual varieties.

actually easier to search the Web for on specific plants than for general infor- n. That's because each plant has a scientific

found that it's usually better to root around the dark corners of your local nursery for unusual plants. That way, you can in- spect them—and often return them if they don't take hold in your garden. Then again, if you want the newest hybrids or a vast selection within a single family or rare plants that are patented or nearly extinct, you have no choice but to go online. Try to buy rooted plants, not cuttings. Otherwise,

you'll have to root them yourself—and lose half of them in the process. In my experience, online nurseries are pretty good about replacing plants that arrive dead, or nearly so, or

even species they've mislabeled or misidentified. To check out the grower, read other buyers' experiences at the plants-by-mail FAQ (pbmfaq.dvool.com). And be prepared to coddle your new arrival for a few weeks. Plants suffer from jet lag and culture shock just like people do.

Most nurseries ship by priority mail on Mondays or Tuesdays. That way, plants arrive in plenty of time for the weekend. After all that digging on the Net, you'll be all charged up to go out and get your hands dirty in the garden. □

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NICHOLS GARDEN NURSERY
nicholsgardennursery.com
Dozens of rosemary, mint, sage, and other herb varieties, plus vegetable and flower seeds

THEATRUM BOTANICUM
greenstranger.com
Eclectic collection of herbs and medicinal plants; cannabis sativa "not available at this time" in the U.S.

Type "lavender" or "tea rose" into a h engine such as Google or AltaVista and get all manner of extraneous leads, from to quilts to country inns. But "lavandula" osa odorata" will take you to nearly every- you want to know—from history and graphs to a nursery offering the plants ible. You can even narrow your search to, growing conditions, by adding a word such oil" to the search string. To find the scien- name, check nationalgardening.com's dic- ty, which converts common names to their ical ones.

ere will come a day when you're tempted to plants from online catalogs (table). I've

FINANCIAL
EDUCATION FOR
WOMEN, A HOT
CHIP STOCK

BusinessWeek Investor

Taking Cover With Covered Calls

Selling options can generate extra income on your portfolio

BY ANNE TERGESEN

The worst of the bear market is behind us, we hope, but that doesn't mean a 1990s-style bull market is ahead. A slower economy, rising energy costs, and badly beaten tech and telecom sectors are likely to keep gains in check. Such an environment is ideal for "covered call writing"—generating extra income by selling call options on stocks you own.

Sure, options are derivatives, and many equate derivatives with risk. But writing covered calls is a relatively conservative strategy. You can make money even if the market doesn't rise. And covered calls provide some protection against falling stock prices, though generally not enough to offset a steep plunge. Still, it's "safer than holding the stock outright," says Todd Salamone, research director at Schaeffer's Investment Research, a Cincinnati publisher that specializes in options.

Options

Covered calls are not only for portfolio protection. Some investors and mutual funds buy stocks specifically because the prices on their options make it attractive to write covered calls (page 134).

Whether you are writing calls on long-term holdings or those you just bought, the mechanism is the same. When you write a covered call, you agree to sell your stock for a specific price by the option's expiration date. Each option has several expiration dates to choose among. Say you purchased 100 shares of IBM at the May 4 closing price of \$115.86, and then wrote a June 120 call. If the stock price is above \$120 when the option expires on June 18—options expire on the third Friday of the month—your shares will be "called" away from you, forcing you to sell at the below-market price of \$120. (Typically, options are exercised only on the expiration date.)

To compensate you for the chance the stock will be called away, you receive a payment for the option, called a premium. The size of that premium is determined by trading in the option when you place your order. On May 4, the premium for the June 120 call was \$4.30—which actually means \$430.00, since each call option covers 100 shares. With that premium in hand, you could withstand a fall of \$4.30 per share—to \$111.56 from a purchase price of \$115.86—before feeling pain. If the stock skids further, say to \$105, you will take a loss. But without the call's premium, your loss



d have been greater. "Covered writing is not insurance strategy," warns James Bittman, senior instructor at the Options Institute, the educational arm of the Chicago Board Options Exchange and the author of *Options for the Stock Investor* (McGraw-Hill, \$32.95). "It provides limited income, which provides limited downside protection." If the stock tumbles and you want to sell, you can cancel the option by buying it back—and negate your stock position.

You don't have to be a heavy hitter to play this game. True, it's more economical to execute big trades, because brokerage commissions are typically about \$25 for the first contract and then decrease sharply. But because it takes only 100 shares to write a call, an outlay of \$3,000 would suffice for a stock trading at \$30. Brokerages often require call writers to have an account worth at least \$10,000 and a net worth of \$25,000 or more, Bittman says.

Before calling your broker, you would do well to consult with a tax expert, because the rules are complex. For instance, when you collect a premium for writing a call, you don't pay taxes on it immediately. Instead, how the option ultimately plays out determines whether you pay short or long-term capital-gains taxes on profits.

Don't write calls on stock you don't want to sell. For example, if you bought IBM at \$20 and your stock is called away at \$110, you will owe capital-gains taxes not only on the premium you re-

ceived but on a hefty \$90 of appreciation. Instead of forking over highly appreciated shares, you are free to buy new stock to satisfy the call. But that's risky because the cost of the new shares could wipe out your profit on the covered call.

MANY CHOICES. The key to successful option writing is selecting the optimal strike price—or the amount for which you would be willing to sell the stock—and expiration date. With most stocks, you get several alternatives. Take IBM. On May 4, when the stock closed at \$115.86, commonly traded strike prices on IBM calls ranged, in \$5 increments, from \$110 to \$125, according to ivolatility.com, a Web site that lists data on call options. For each strike price, an IBM call writer could choose between six expiration dates.

The strike price you select depends on how you view IBM's prospects. For example, if you think the stock could hit \$130 in the near term, it makes little sense to sell a June call with a strike price of \$120. Sure, you will pocket a \$4.30 premium. But if the stock reaches \$130, your shares will be called away at \$120.

Conversely, if you think IBM might be under some near-term pressure, you can get some protection by writing a call at a strike price below where the stock currently trades, such as \$110. The fat premium on IBM's June 110 call—\$9.90—would protect someone who bought at \$115.86 until the stock fell to \$105.96.

So what are you really earning by writing calls? First, calculate the "static" rate of return (table). This is the amount you will earn on the call if the stock is at its purchase price when the call expires. Assuming a purchase price of \$115.86, IBM's June 120 call, for instance, has a static return of 3.9%, so you are protected for as much as a 3.9% decline in the stock. (Returns are actually lower once commission costs are factored in.)

You may be more tempted by the static return

A covered call obligates you to sell a stock for a set price within a given period of time. The premium offsets the risk you take that the stock will be called away

Protection and Potential

To quantify the potential payoff of writing call options, figure out the static and if-called rates of return. The static return tells you what you'll earn if the stock is at the purchase price when the call expires—and also indicates your downside protec-

tion. The if-called return shows what you'll earn if your shares rise enough to be called away—and shows how much of a stock's runup you can participate in. This example doesn't include commissions and dividends that you must normally factor in.

Stock purchase price: \$115.86 June 120 call premium: \$4.30

STATIC RETURN

Call Premium	4.30
+ Dividends	+0
- Call Commission	-0
Total	4.30



Stock purchase price	115.86
- Call Premium	-4.30
+ Commission	+0
Total	111.56

= 3.9%

IF-CALLED RETURN

Call Premium	4.30
+ Dividends	+0
- Call Commission	-0
+ Difference between option strike price and stock purchase price	+4.14
Total	8.44



Stock purchase price	115.86
- Call Premium	-4.30
+ Commission	+0
Total	111.56

= 7.6%

Data: James Bittman, senior instructor, Options Institute of the Chicago Board Options Exchange

Brokerage firms typically require call writers to have an account worth \$10,000 and a net worth of at least \$25,000

on the June 115 contract. But you're getting a higher premium because you face another risk—that the stock will rally and you will be forced to give up the stock at a below-market price.

With this in mind, many pros opt for a strike price slightly above a stock's current price. They are still able to capture a fairly high premium, but they also leave some room for the stock to rise before hitting the strike price. This guarantees them a piece of the action in a rally.

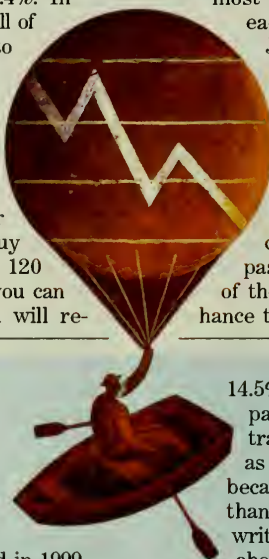
TIGHT CAP. How much? Calculate the "if called" rate of return. Generally, the more a call protects on the downside, the stingier its payoff in a rising market. In the case of IBM's June 115 call, the premium is big enough to offset a 6.1% sell-off on a purchase price of \$115.86. But if IBM rises, the call writer's gains are capped at 5.4%. In contrast, the June 120 call covers a fall of up to 3.9%, while positioning you to share in a gain of up to 7.6%. That may not sound like much, but if you earn even 3.9% in six weeks, that equates to an annualized return of more than 30%.

As a strategy, covered call writing is most profitable when your shares are called. Why? Say you buy IBM at \$115.86 and write a June 120 call. If the stock rises above \$120, you can kiss your stock goodbye. But you will re-

ceive \$4.14 of appreciation, plus a \$4.30 premium. In contrast, if the stock rises to \$119, the call will expire worthless and you will get the premium plus an unrealized gain of \$3.14. "If the stock gets called away, you've made the trade," you could on the trade," says Bill Yates, president of Dyr Associates, a Vienna (Va.) risk management consulting firm.

Once you have settled on a strike price and an expiration date, pros often write the call that throws off the most premium per unit of time. Compare IBM's May 120 and June 120 calls. On May 4, the May came with a \$4.30 premium, while the June netted \$4.30. On May 4, the May contract was a better deal. Why? It was set to expire in 14 days, giving you most \$0.12 per day vs. about \$0.10 each of the 42 days remaining on the June call.

Covered-call strategies force investors to master a new set of rules and calculations beyond what it takes to invest in stocks. With many bullish stock market strategists arguing that equity market turns will be more modest in the coming decade than they were in the past two, option writing may be one of the few ways investors can really enhance their returns.



HOW MUTUAL FUNDS COME CALLING

Mutual-fund companies created "option income" funds in the 1970s. In the 1980s, they all but disappeared. That's not surprising. How could funds that sell off much of the upside potential in their portfolios thrive in a bull market?

Now, the option income fund is making a comeback. Kelmoore Investment Co. of Palo Alto, Calif., recently launched its third fund specializing in writing covered calls—a strategy that generates income by selling the right to purchase fund holdings at specific prices. At least one similar fund, the

Dobson Covered Call Fund, started in 1999.

These funds buy stocks for the sole purpose of writing calls. The Kelmoore Strategy Fund aims to earn enough from call premiums on stocks in its blue-chip portfolio, which includes Citigroup and General Electric, to pay a monthly dividend of about 1.25% of its assets. Over the past 12 months, it has exceeded this goal with a yield of 22.5%.

Still, the fat yield didn't keep the fund from losing ground. In 2000, Kelmoore Strategy declined by

14.5%, including dividends. The fund had paid a price for its heavy concentration in technology stocks, such as Microsoft and Cisco Systems, because those stocks lost far more than the fund was able to earn by writing calls. Therein lies a lesson about calls: "No matter how attractive the premium, you still have to be right about the stock," says Michael Schwartz, options strategist at CIBC Oppenheimer. This year, the fund is up 0.93%, putting it about three percentage points ahead of the Standard & Poor's 500-stock index.

Kelmoore Strategy is saddled with high costs. Distributed through brokers, it charges a sales load of 5.5% on top of annual expenses of 2.25%. Dobson is a no-load fund with an expense ratio of 1.5%, only 0.09 percentage points higher than the average fund's. In 2000, the Dobson fund fared relatively well, rising 0.4%. So far this year, it is up 5.1%.

These funds are not exactly tax-efficient. The income is considered short-term capital gains and is taxed at ordinary income tax rates—not the more favorable long-term capital-gains rate. So fund shares are best owned in a tax-deferred account.

Anne Terges

Writing Options For Income

FUND/TICKER	TOTAL RETURN*		CONTACT
	2000	2001**	
KELMOORE STRATEGY KSAIX	-14.5%	0.93%	877 328-9456
KELMOORE STRATEGY EAGLE KSEAX	N/A	-21.2	877 328-9456
KELMOORE STRATEGY LIBERTY KSLAX	N/A	-7.8	877 328-9456
DOBSON COVERED CALL N/A	0.4	5.1	877 236-2766

*Appreciation plus reinvestment of dividends and capital gains

**Through May 4, except April 30 for Dobson N/A=Not applicable

Data: Company reports, Standard & Poor's



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FINANCIAL EDUCATION FOR UNDERGRADS



BY TODDI GUTNER

Fewer women than men are adept at money management. A pioneering program at Smith College proposes to remedy that

Imagine college courses that teach practical financial management and investing skills. I sure could have used some, but they just weren't available when I was in college in the early 1980s.

Fortunately, several women in a position to make a difference had the same notion. As a result, this fall, Smith College, an all-women's school in Northampton, Mass., will offer the first comprehensive financial education program aimed at undergraduates. The 6- to 10-week noncredit evening and weekend courses will have no prerequisites and will emphasize financial education. "It's important to get women interested in de-

veloping these lifelong skills and make the information relevant to them and their lives," says Laura D'Andrea Tyson, a 1969 Smith graduate who served on its board in 1997 and was one of the women who suggested such a program. Formerly head of the White House Council of Economic Advisers in the Clinton Administration, she is now dean of the Haas School of Business at the University of California at Berkeley.

BACKING HER WORDS. No doubt there is a need for such an initiative. A just released Yankelovich Partners study done for Oppenheimer Funds found that 47% of single women aged 21 to 34 aren't very knowledgeable when it comes to investing, vs. 33% of single men. The same study found that 47% of single women have an unpaid balance on their credit card, vs. 38% of single men. Finally, 48% of all women in that age group say they live paycheck to paycheck, vs. 38% of men. "Women will never be seen as a force in our global economy unless they have financial management skills for both their professional and personal lives," comments Ann Kaplan, a Smith trustee who graduated from the school in 1967 and went on to become one of the first women partners at Goldman Sachs.

Kaplan is backing her words with her checkbook. She and Goldman Sachs are putting up \$2.5 million to fund the program's launch. Last year, Kaplan urged the Smith faculty to draw up a formal proposal after she and college President Ruth Simmons discussed the idea. "The vast

majority of women in our country are in situations where men handle the money," Kaplan. "I don't think there have been enough opportunities for women to learn basic financial skills."

Indeed, Kaplan's own research found that general grammar, middle, and high schools were offering good financial education programs, but such courses were sorely lacking at the college level. Smith's Women's Financial Education program, which plans to offer four courses over the next school year, is designed to reverse that trend. For example, a course in financial decision making will deal with budgeting and using financial planning simulation models. Another will discuss current events in the financial markets and how they affect individuals. A third class will cover entrepreneurship. The last, on principles of investing, will teach students how to analyze financial data such as corporate earnings reports, and how to understand asset allocation.



CATALYST: Goldman Sachs' Ann Kaplan helped start the program

Professors will teach the weekly classes, and guest lectures by financial leaders and alumni.

The school expects to have no trouble attracting participants. In the past year, student investment clubs have asked Mahdavi, the economics professor who will lead the program, to be their faculty adviser. "The time is right, the need is here, and the demand is here," she says.

For Smith, this is but a beginning. The school is using the seed money to create a Center for Women's Financial Education that aims to develop a model program for other institutions. "We hope it becomes so successful that it can be replicated," says Mahdavi. With the need well established, that wish couldn't come true soon enough.

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BEWARE THIS STOCK MARKET FAVORITE



BY ROBERT BARKER

rb@businessweek.com

Although shares of chipmaker NVIDIA are soaring—up 175% this year—and hype around the stock is over the top, insiders have been selling

At Taco Bell, the only thing I ever liked was Dinky the chihuahua, star of the Mexican fast-food chain's television ads. Then, suddenly last summer, he got fired. So why was I lurking the other day at a Satellite Beach (Fla.) Taco Bell? Looking for X. That's X as in Xbox, the video-game player that Microsoft is set to roll out this fall with a gordita-sized marketing budget and promotional hoopla at Taco Bell.

No sign of Xbox there yet. Where you can't miss it, though, is all around NVIDIA, today's hottest maker of semiconductors and, as it happens, supplier of two key Xbox chips. While most chip stocks are sagging, NVIDIA is soaring, up 175% this year, to new highs over \$94 (chart). Xbox anticipation isn't all that's fueling NVIDIA's ascent. "It's the king of graphics" chips, says Manoj Nadkarni, principal analyst at ChipInvestor.com, a site that tracks chip companies. "They have practically driven the competitors out of business." The company's chips are turning up in a wide variety of PCs and workstations. Sales rose 96%, to \$735 million, in the fiscal year ended on Jan. 28. Profit grew 162%, to \$100 million. And with earnings per share seen rising 35% or so this year and next, NVIDIA right now may just be Wall Street brokers' favorite technology stock.

If you ask me, it's also the most dangerous. Ranked No. 4 in *BusinessWeek's* latest Info Tech 100, NVIDIA is a solid citizen of Silicon Valley. And against some steep odds, including the impending launch by Nintendo of its new GameCube, Xbox may oust Sony's PlayStation2 as kids' No. 1 gotta-have. But if you simply look at the hype around NVIDIA stock, along with who owns it and who has been selling it, you'll see that buying NVIDIA right now is a risk that even little Dinky, who once confronted Godzilla, wouldn't dare to run.

You can get a sense of the passions NVIDIA is inciting by checking the investor message board devoted to it at Yahoo! From 6 a.m. to 6 p.m. on May 1, for example, ticker symbol NVDA drew 379 posts, or one every other minute, such as this one from "marketsavant": "NVDA IS EXCITING. I love NVDA. An Extraordinarily Wonderful Trad-

ing Vehicle...! It's ECSTASY!" Day traders bought this stock because its "float"—the shares available to trade freely—is small next to its trading volume. Lately, 13% of its float is turning over on an average day. That's double the turnover of Amazon.com, and all of that trading has been sending the price on some wild swings. On May 1, with no substantial news, NVIDIA traded up \$82.25 to \$91.30 a share.

BIG STAKES. Day traders are by no means the only investors that are high on NVIDIA. Fidelity Investments is the biggest single stockholder, with a stake of almost 15%. Likewise, Janus Capital owns 4.7 million shares, or nearly 7% of the company. In one way that amounts to two big votes of confidence in NVIDIA, what it also tells us is: Having loaded up on the stock at prices, the next trades these fund giants will be sales.

Trimming is a portfolio strategy.



NVIDIA: Chip Standout



GAME PLAN: Xbox uses NVIDIA chips

What's wrong with this? Nothing, really. I would do the same thing if I owned a risky stock that was trading at nearly 9 times sales and 10 times cash flow—no matter how bright the company's future. Even if Wall Street bulls happen to be right and NVIDIA earns the consensus estimate of \$1.50 a share, a buyer of the stock today would be paying 50 times this year's earnings.

Can NVIDIA still climb? With its limited float and the ecstatic attentions of day traders, "NVDA will be above 100 by next week," said a recent posting on Yahoo! "No doubt about it. That might reassure some prospective investors who want to take their investing seriously from an anonymous adviser whose screen name happens to be "the_retarded_optimist."

BusinessWeek online

For barker.online, go to www.businessweek.com/investor/ and click on "Co"

SCHERING AND MERCK?



GENE G. MARCIAL

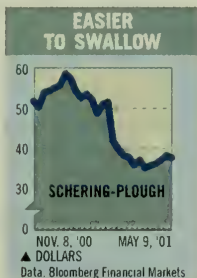
Schering-Plough is popping up as Merck's to-buy. At Children's earnings robust. And a pro gets a picture for AOL and Liberty

Schering-Plough (SGP) is looking puny: Its stock is one of the big losers among pharmaceuticals—down 33% this year. That has sparked speculation that Schering might become buyout bait. Rumors swirled when shares tumbled to 37, down from 56 in mid-February, after Schering disclosed that the Food & Drug Administration was looking into quality-control problems at its New Jersey and Puerto Rico plants.

CEO Richard Kogan insists Schering isn't for sale. But whispers persist: Drug giant Merck, said to have talked to Schering about a buyout in mid-1999 and gotten a rebuff, approached Schering again after the FDA problems emerged, says an investment banker close to the industry. Schering has again turned Merck down, says this pro. But Merck isn't giving up: The banker says Merck has proposed a buyout price in stock of 65 a share, or \$91 billion in total. He sees Schering ultimately coming around.

Merck has a market cap of \$176 billion, vs. Schering's \$55 billion. Already, Merck and Schering have joint ventures in developing certain respiratory and cholesterol-reduction drugs.

Analyst Steven Tighe of Merrill Lynch figures Schering could be worth \$42 to \$72 a share, depending on whether the buyer is a financial group or a drugmaker. The price will vary, he says, depending on the buyer's revenues and Schering's earnings from 2001 to 2003. Tighe says a drug company could save a lot in buying Schering because it could cut costs on operations overlap. Such synergy, he says, could range from 3% to 8% of their combined sales. But both Schering and Merck declined comment as a matter of policy.



ALL DRESSED UP AT CHILDREN'S PLACE

With consumer spending dragging, retailers are finding it tough to meet Wall Street's expectations. But Children's Place Retail Stores (PLCE), which sells private-label clothes for kids, may pull a surprise: Although it had guided analysts on Apr. 12 to trim first-quarter earnings estimates from 44¢ a share to 38¢, management will probably post 48¢, even though the consensus estimate is 38¢. One reason: April sales exceeded estimates by a lot.

"The company has been expanding aggressively and has broad appeal" in the \$22 billion children's apparel market, says Larry Leeds Jr., chairman of Buckingham Capital Management. Its high-



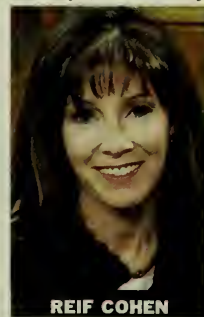
quality, fashionably styled kids' wear—priced way below rivals—has made Children's a big winner, he adds. Based on its growth, "the stock should double during the next two to three years," says Leeds. The stock is cheap—trading at 24, or 12 times 2001 consensus estimate of \$1.80, he notes.

CEO Ezra Dabah, who says Children's Place earnings have grown at a compounded annual growth rate of 77% in the past three years, expects to beat the 2001 consensus estimate. One brokerage analyst foresees earnings of \$1.93 a share in 2001 and \$2.43 in 2002. The company has twice as many stores as it did two years ago: 437 outlets in 43 cities. This year, 120 new stores will be added.

AOL AND LIBERTY: TOPS IN MEDIA

Merrill Lynch's Jessica Reif Cohen, the Street's media and entertainment maven, doesn't pull her punches when it comes to "sell" ratings: Disney, News Corp., Fox, Univision, and Cablevision all got dented when she socked it to them last year. "They were trading at high multiples but, with the economy slipping, I saw that consumer and advertising support wouldn't be there," she says. Reif Cohen, who has been covering media and entertainment for 18 years, pays close attention to quality of management, growth, asset value, and cash flow.

Now, Reif Cohen has reversed course and has turned bullish. Among her current top buys: AOL Time Warner (AOL) and Liberty Media Group (LMG/A). AOL delivered robust results during "one of the toughest operating environments in years," notes Reif Cohen. AOL is in a good spot in this weak advertising market, she says, since only 25% of its revenues come from ad revenues. Cost-cutting and leveraging AOL's infrastructure will keep driving growth at AOL, she adds. Her 12-month target for the stock, now at 52, is 65. She sees earnings of \$1.25 a share in 2001 and \$1.60 in 2002.



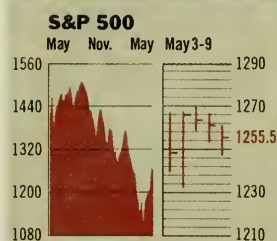
REIF COHEN

Liberty, another media, entertainment, and communications company, is also well positioned to weather the storm with its diversified assets, says Reif Cohen. Its core businesses, she notes, such as Starz Encore Group and Discovery Communications, continue to bring solid results—with cost-cutting offsetting the weak ad revenues. Her 12-month target is 20 based on a sum-of-the-parts valuation. Over the next 18 to 24 months, Reif Cohen sees the stock zipping up to 25 to 30. The stock is now 16.85.

BusinessWeek online

Read Gene Marcial's Inside Wall Street Online column Tuesday afternoons at www.businessweek.com/today.htm. And see him Fridays at 1:10 p.m. EST on CNNfn's *The Money Gang*.

Stocks



COMMENTARY

Weak economic news coupled with profit-taking on the heels of a four-week rally sent the indexes south this week. The Nasdaq, down 2.9% for the week, was hit particularly hard after Cisco reported a staggering \$2.7 billion net loss on May 9 and painted an unclear picture going forward. The S&P 500 was down 0.9%, and the Dow was down 0.1% for the week.

Data: Bloomberg Financial Markets
Bridge Information Systems, Inc.

U.S. MARKETS

	May 9	Week	Year to date	Last 12 months
S&P 500	1255.5	-0.9	-4.9	-11.1
Dow Jones Industrials	10,867.0	-0.1	0.7	3.1
Nasdaq Composite	2156.6	-2.9	-12.7	-39.8
S&P MidCap 400	511.2	-0.5	-1.1	6.9
S&P SmallCap 600	222.5	-0.1	1.3	10.4
Wilshire 5000	11,582.9	-1.0	-4.9	-11.7

SECTORS

	May 9	Week	Year to date	Last 12 months
BusinessWeek 50*	887.8	-0.7	-8.5	-25.5
BusinessWeek Info Tech 100**	506.7	-3.5	-10.4	-43.8
S&P/BARRA Growth	626.9	-0.9	-8.8	-25.5
S&P/BARRA Value	628.8	-1.0	-1.2	5.5
S&P Energy	951.8	3.4	2.1	9.3
S&P Financials	154.7	-0.8	-6.1	18.8
S&P REIT	87.2	-0.6	-0.9	8.7
S&P Transportation	726.3	1.3	4.1	19.9
S&P Utilities	331.3	-0.7	-5.5	25.9
GSTI Internet	142.8	-7.7	-21.4	-68.2
PSE Technology	762.3	-3.8	-6.4	-24.6

*Mar. 19, 1999=1000 **Feb. 7, 2000=1000

BEST-PERFORMING GROUPS

	Last month %	Last 12 months %
Office Equip. & Supplies	40.6	115.9
Instrumentation	35.8	100.8
Semiconductors	35.7	86.1
Communications Equip.	32.5	84.7
Invest. Banking/Brkrge.	24.1	79.9

GLOBAL MARKETS

	May 9	Week
S&P Euro Plus (U.S. Dollar)	1233.1	-2.6
London (FT-SE 100)	5893.7	-0.6
Paris (CAC 40)	5492.1	-1.5
Frankfurt (DAX)	6063.9	-2.4
Tokyo (NIKKEI 225)	14,084.9	1.1
Hong Kong (Hang Seng)	13,585.1	-1.7
Toronto (TSE 300)	8070.6	0.7
Mexico City (IPC)	6106.4	0.0

FUNDAMENTALS

	May 8	Wk.
S&P 500 Dividend Yield	1.25%	1.2
S&P 500 P/E Ratio (Trailing 12 mos.)	28.1	28.1
S&P 500 P/E Ratio (Next 12 mos.)*	22.1	22.1
First Call Earnings Revision*	-4.29%	-4.5

*First Call Corp.

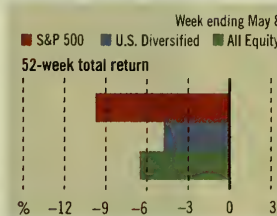
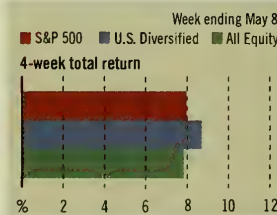
TECHNICAL INDICATORS

	May 8	Wk.
S&P 500 200-day average	1343.1	1348.1
Stocks above 200-day average	66.0%	66.0%
Options: Put/call ratio	0.61	0.58
Insiders: Vickers Sell/buy ratio	2.71	2.74

WORST-PERFORMING GROUPS

	Last month %
Metal & Glass Containers	-9.6
Housewares	-6.6
Hospital Management	-6.5
HMOs	-6.5
Toys	-5.6

Mutual Funds



Data: Standard & Poor's

EQUITY FUND CATEGORIES

4-week total return	%	52-week total return	%
Leaders		Leaders	
Technology	20.4	Financial	30.9
Communications	14.5	Small-cap Value	20.9
Small-cap Growth	13.6	Mid-cap Value	20.3
Japan	13.3	Natural Resources	16.9
Laggards		Laggards	
Latin America	-0.6	Technology	-39.7
Utilities	1.5	Communications	-38.6
Real Estate	2.6	Japan	-29.8
International Hybrid	2.8	Diversified Pacific/Asia	-26.1

EQUITY FUNDS

4-week total return	%	52-week total return	%
Leaders		Leaders	
Black Oak Emerg. Technology	41.5	Schroder Ultra	90.4
Red Oak Technology Select	41.4	CGM Focus	80.7
ProFunds UltraOTC Inv.	41.3	Burnham Financial Svcs. A	71.8
Conseco Science & Tech. A	38.4	Potomac Internet Short	64.4
Laggards		Laggards	
ProFunds UltraShort OTC	-36.8	ProFunds UltraOTC Inv.	-80.5
Rydex Dynamic Venture 100	-36.6	Jacob Internet	-74.3
Potomac Internet Short	-24.2	Potomac Internet Plus	-70.4
Potomac OTC Short	-20.5	ING Internet A	-69.8

Interest Rates

KEY RATES	May 9	Week ago
MONEY MARKET FUNDS	4.54%	4.64%
90-DAY TREASURY BILLS	3.70	3.89
1-YEAR TREASURY BILLS	3.64	3.95
10-YEAR TREASURY NOTES	5.17	5.31
30-YEAR TREASURY BONDS	5.67	5.71
30-YEAR FIXED MORTGAGE†	7.01	7.16

†BancQuote, Inc.

BLOOMBERG MUNI YIELD EQUIVALENTS

Taxable equivalent yields on AAA-rated, tax-exempt bonds, assuming a 31% federal tax rate.

	10-yr. bond
GENERAL OBLIGATIONS	4.45%
TAXABLE EQUIVALENT	6.45
INSURED REVENUE BONDS	4.58
TAXABLE EQUIVALENT	6.64

THE WEEK AHEAD

BUSINESS INVENTORIES Monday, May 14, 8:30 a.m. EDT ► Inventories probably fell 0.2% again in March, after falling 0.2% in February. That is the median forecast of economists surveyed by Standard & Poor's MMS, a unit of The McGraw-Hill Companies.

INDUSTRIAL PRODUCTION Monday, May 14, 9:15 a.m. EDT ► Factory output likely slipped 0.2% in April, after rising 0.4% in March. The average operating rate likely fell to 79%, from 79.4% in March.

FOMC MEETING Tuesday, May 15, 9:00 a.m. EDT ► The Federal Reserve Board's Open Market Committee will meet to set monetary policy. Based on the S&P MMS survey, economists unanimously expect another one-half percentage point cut in the federal funds rate.

CONSUMER PRICE INDEX Wednesday, May 16, 8:30 a.m. EDT ► Consumer prices for goods and services probably rose in April by 0.3%. Excluding food and energy, prices likely grew by just 0.2%.

HOUSING STARTS Wednesday, May 16, 8:30 a.m. EDT ► Housing starts in April slipped to an annual rate of 1.6 million from 1.61 million in March.

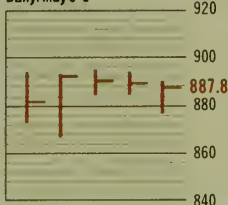
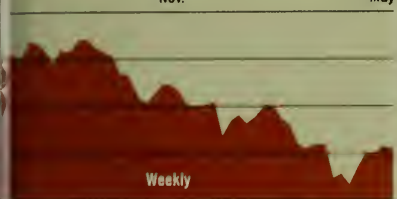
INTERNATIONAL TRADE Friday, May 18, 8:30 a.m. EDT ► The March trade deficit for goods and services probably widened to \$29 billion, from \$27 billion in February.

FEDERAL BUDGET Friday, May 18, 12:00 p.m. EDT ► The U.S. Treasury will report a \$170.9 billion surplus in April.

Nov

May

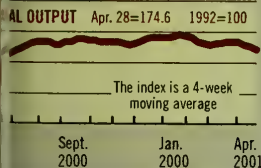
Daily: May 3-9



COMPANY PERFORMANCE

Company	% change		Rank	Company	% change	
	Week	Since 3/1/01			Week	Since 3/1/01
National	0.3	-3.6	26	Verizon Communications	-5.4	11.1
Petroleum	5.5	0.1	27	Alza	1.4	22.5
	-4.9	19.4	28	Citigroup	-2.3	1.6
	-2.8	15.8	29	Sun Microsystems	-5.8	-4.0
Materials	-6.7	12.6	30	Merck	3.2	-3.0
Financial	-3.0	5.8	31	El Paso	0.9	-6.3
Petroleum	4.9	23.3	32	Altera	-3.0	5.0
	3.4	1.2	33	Marsh & McLennan	0.8	-5.2
e	4.7	9.5	34	Household International	0.9	13.1
	-0.6	-20.2	35	Chevron	3.7	9.9
Others Holdings	-0.8	12.5	36	SBC Communications	-0.3	-7.1
	-6.9	-4.5	37	Mercury Interactive	-8.2	9.8
	-7.2	-18.0	38	AOL Time Warner	0.8	18.2
Corporations	2.2	-7.4	39	Washington Mutual	3.7	1.8
Financial	-0.4	-4.2	40	General Dynamics	-1.0	16.5
Technology	-3.7	15.6	41	Comcast	-2.3	0.6
	-10.3	4.3	42	Morgan Stanley Dean Witter	-2.2	2.3
less	3.4	17.6	43	Tellabs	-6.4	-14.3
gy	2.3	10.8	44	Exxon Mobil	3.7	10.2
Communications	6.0	-21.7	45	Scientific-Atlanta	-2.7	28.8
e Financial	-1.1	14.2	46	U.S. Bancorp	0.1	-8.2
roleum	5.1	11.3	47	Paychex	6.9	-11.9
ices	-8.0	12.5	48	Merrill Lynch	-2.0	9.4
ices	6.5	3.6	49	Bed Bath & Beyond	-6.9	4.0
Health	2.2	3.0	50	Texas Instruments	-6.0	15.9

Change from last week: -0.4%
Change from last year: 4.5%



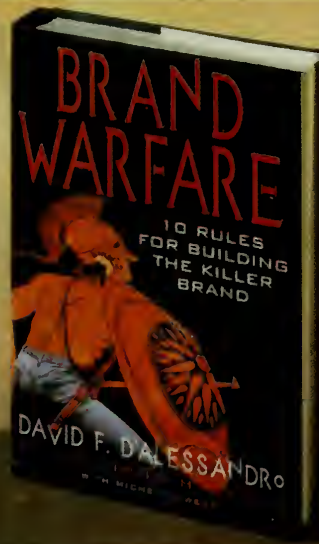
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BusinessWeek (ISSN 0007-7135) published weekly, except for one week in January and August, by The McGraw-Hill Companies, Inc. Executive, Editorial, Circulation, and Advertising: 1221 Avenue of the Americas, New York, N.Y. 10020. U.S. subscriber rate \$54.95/year; Can. \$69/year. Periodicals postage paid at New York, N.Y., and at additional mailing offices. Postmaster: Send address changes to BusinessWeek, P.O. Box 430, Hightstown, N.J. 08520.

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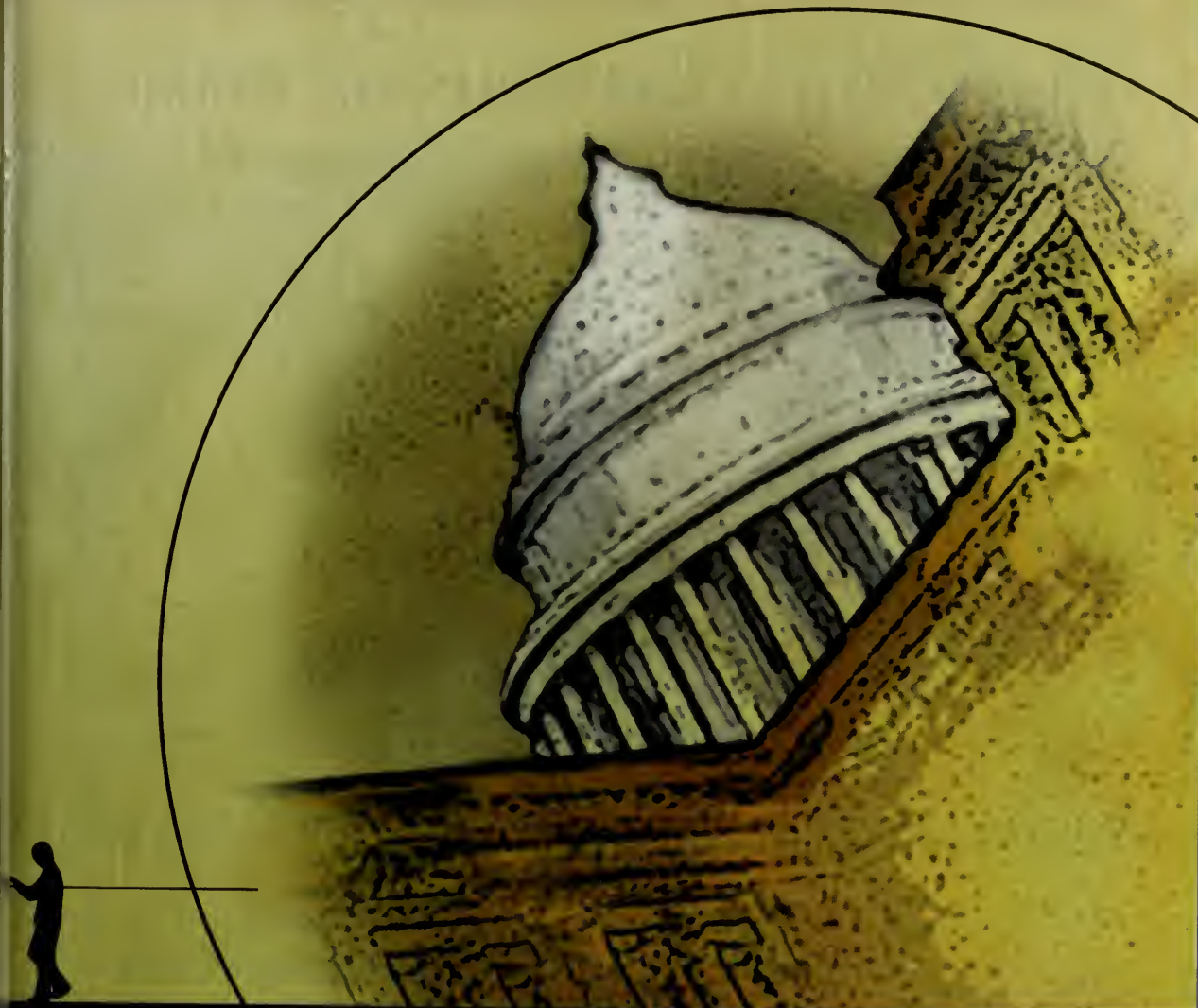
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PRODUCTIVITY GROWTH HAS NOT ENDED

Late converts to the higher productivity/faster economy paradigm are beginning to bail out. The first-quarter drop in productivity and jump in unit labor costs has some Wall Street economists and Washington pundits crowing that the New Economy was, in the end, nothing but a bubble. Pay them no mind. A single-quarter decline in productivity is hardly a sign of fundamental change. Instead, it happened because of a sudden and unexpected cyclical downturn in the economy that led to a dramatically swift reduction in output (page 38). Once they caught on, managers began to adjust fast, but not fast enough to prevent work hours for the quarter from rising. That's why productivity dropped. This will not continue. Indeed, productivity may return to its higher trend line even faster than in past downturns.

Why? Speed is a powerful force shaping this cyclical business downturn. CEOs reacted with unusual quickness in cutting inventories and curbing capital spending once they realized just how bad it was going to get. They are now shedding excess labor with the same kind of dispatch, desperately seeking to trim costs and revive profits. Indeed, the rise of a flexible contingent labor force in recent years is making management's job much easier than in the past. Layoff announcements are running at a record level and

the unemployment rate is rising sharply. Once companies shrink their labor forces to be in synch with productivity, productivity growth will begin again. As unemployment rises, so will productivity. This short-term swing in productivity is nothing new. It happens, to a degree or another, in virtually every business cycle. Even in the high-productivity '60s, there were quarters when productivity growth went negative.

But the short-term cyclical rise and fall of productivity should not be confused with the more important long-term trend. *BusinessWeek* believes that the fundamentals for productivity haven't changed. The spread of information technologies and globalization has raised the trend rate of productivity. Nonfarm productivity rose by 2.8% between 1995 and 2000, nearly twice the rate of the previous 25 years. This is not likely to be reversed.

The volatility of this high-tech-driven business cycle is proving problematic for economists and Washington policymakers alike. There may well be more quarters ahead showing weakness, but Washington policymakers should worry that the gains in productivity growth are being lost. They should base policy on the long-term fundamentals, not those still look good for productivity.

THE FCC SHOULD CRACK DOWN ON THE BELLS

Federal Communications Commission Chairman Michael K. Powell is off to a good start in asking Congress for a bigger stick to whack the Baby Bells with when they keep competitors out of their markets. To the surprise of many, Powell wants to beef up FCC fines to force the Bells to obey the Telecommunications Act of 1996 and open their networks to competitors. It's not a moment too soon. Monthly prices for digital subscriber line broadband Internet connections charged by the Bells just went up 25%. Thanks to the widespread bankruptcy of telecom startups, the Bells face even less competition in their markets than ever.

When Congress passed the telecom law, it promised consumers a world of new services, lower prices, and, above all, more competitive choices. Cable and phone companies would invade one another's turf, startups would wreck havoc, and the Internet would shake up traditional telecom oligopolists. It hasn't happened. Cable companies have been very slow in turning their "pipes" into conduits for local phone service. And the Bells discovered that their grip on the old copper "last mile" connection to homes and offices was really golden.

Five years after Washington acted to open up all telecom markets, only 3.2% of residences and small businesses currently get local service from non-Bell new carriers. In the long-distance market, prices have fallen 34% since the 1984 breakup of AT&T and the advent of competition. But local

phone prices are up 70.2% since that time. Cable prices are substantially as well. And now prices that consumers pay for broadband connections are soaring, even as the wholesale price of broadband is falling to new lows.

Startup telecoms such as Covad Communications Inc. and others charge that the Bells have consistently denied them access to the last mile or overcharged them, reducing their profitability. Indeed, many telecom startups might not have survived such deep trouble had they been allowed access to the Bells' networks over the past five years, as the law requires.

The fact is that Congress is largely responsible for the continued oligopoly in local phone markets. It told the FCC it could levy only ludicrously low fines when it wrote the Telecom Act. The FCC fines were so trivial that it made no economic sense for the Bells just to pay them to keep their startups out. And they did. SBC Communications Inc. has paid the FCC many fines over the past five years.

It may be that wireless and direct broadcast satellite companies will bring some competition to the Bells in the future. Cable companies may learn to deliver phone service as well. But the FCC cannot simply wait and allow the Bells to continue to shut out existing competitors. Congress should grant Powell enough discretionary power to force the Bells to follow the spirit, as well as the letter, of the telecom law. The rollout of broadband is a national goal of the highest

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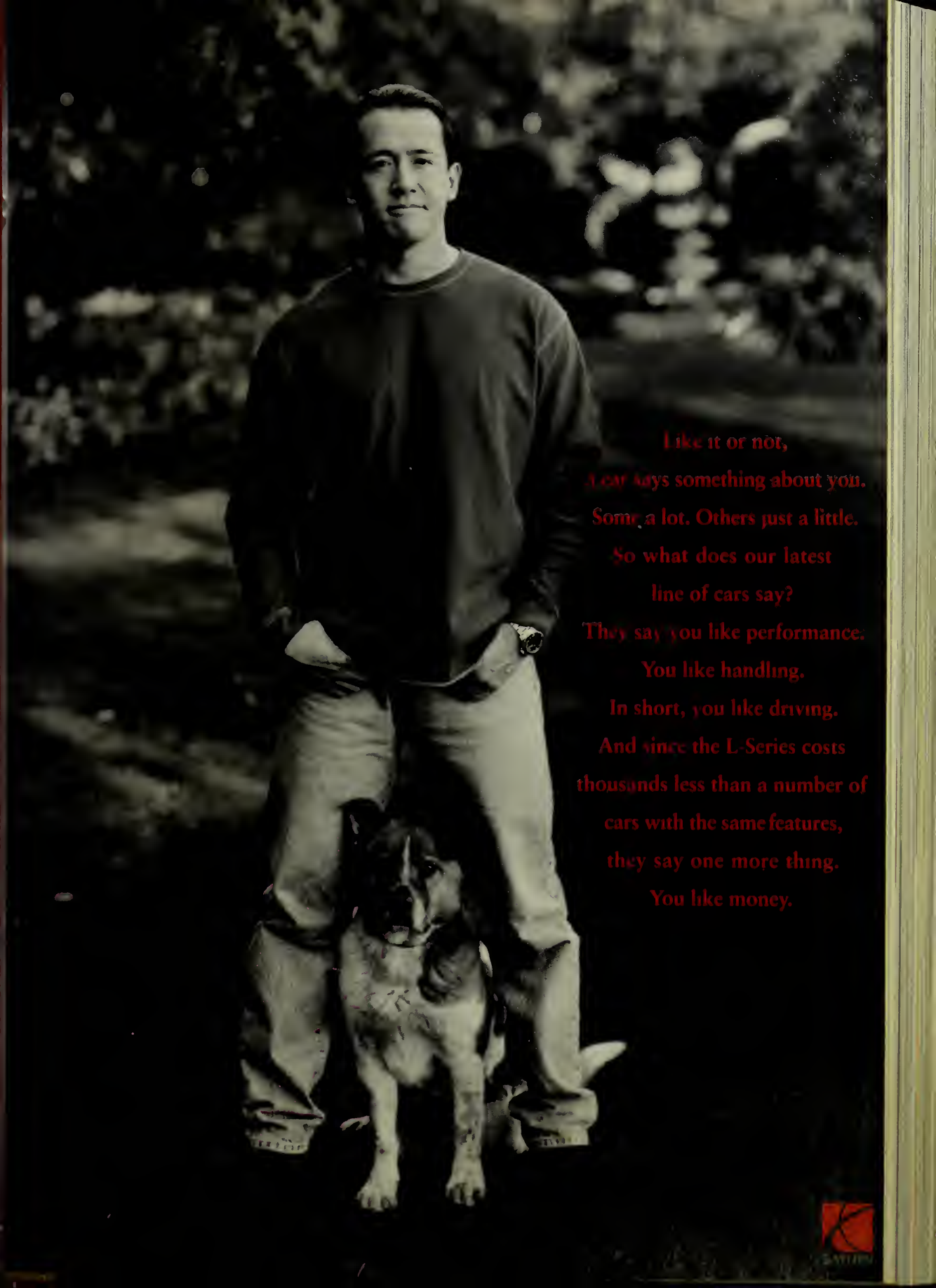
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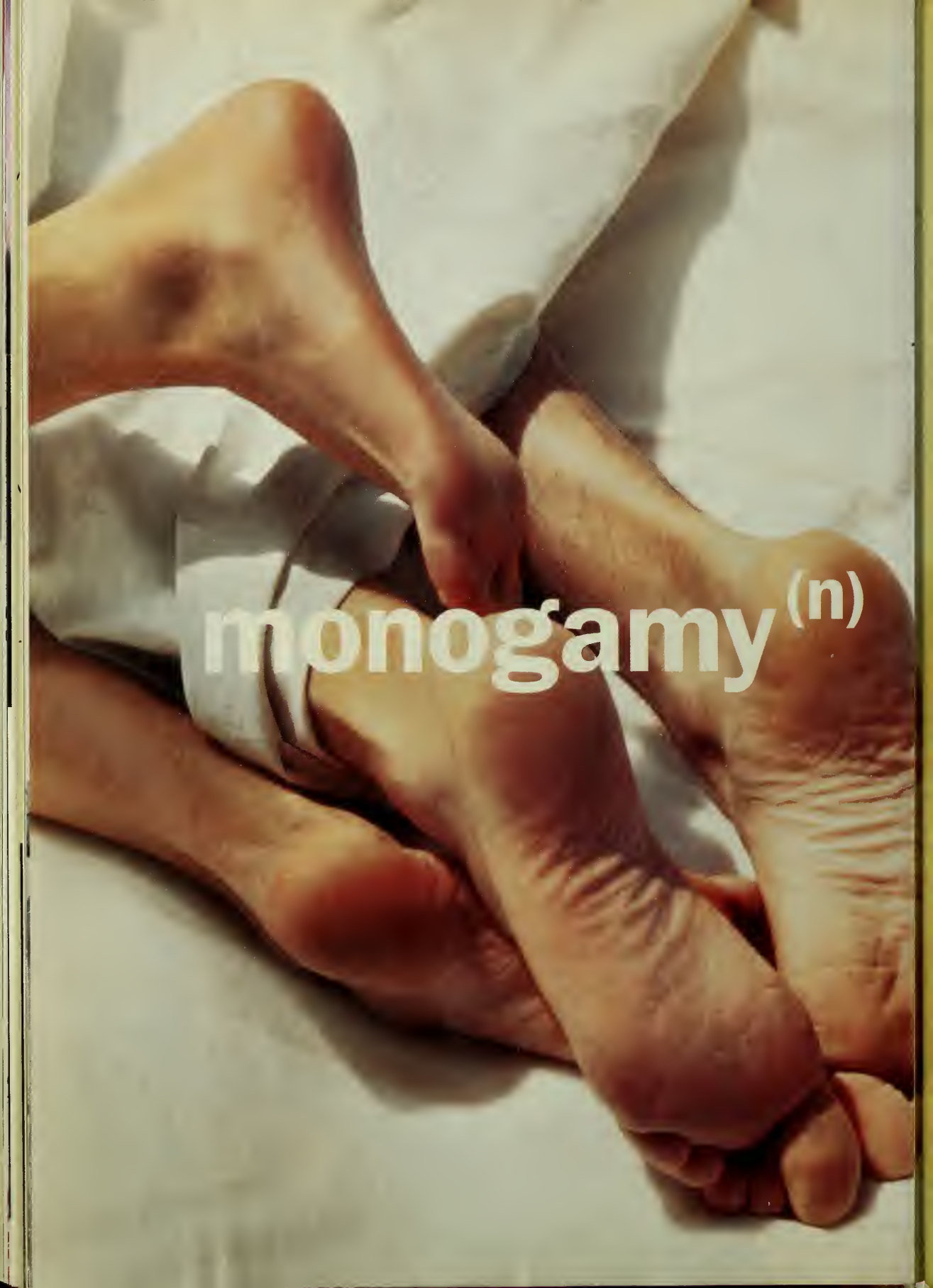
Corporate Finance

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Personal Banking

A photograph of four human feet, likely belonging to two different people, resting on a white, wrinkled fabric surface. The feet are positioned in a way that they appear to be intertwined or overlapping. The lighting is soft, creating gentle shadows. Overlaid on the image in a large, white, sans-serif font is the word "monogamy" followed by a superscripted "(n)".

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MANAGEMENT

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Dennis Kozlowski, and the stealth industrial conglomerate he runs, has acquired about 120 major companies during his nine-year tenure. From home security to flow control, the businesses on the Tyco roster are mostly leaders in their fast-growing categories—and pull in a combined \$38 billion annually. His latest acquisition: CIT, the financial giant. Kozlowski wants Tyco to become the next General Electric. And, of course, he'd love to be the next Jack Welch

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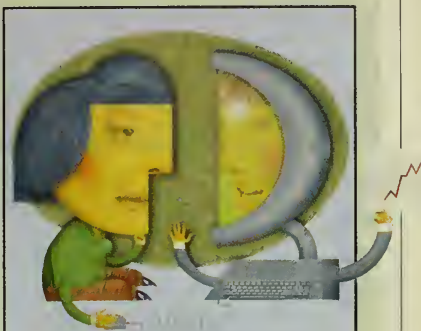
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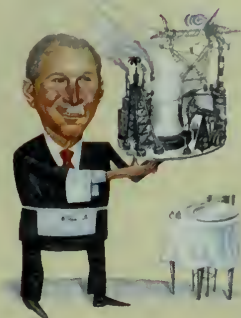
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WAL IS SMELLING GOOD AGAIN

Thanks to technology, it's getting
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Up Front

EDITED BY SHERIDAN PRASSO



GUESSING GAMES

TRYING TO TIME THE MICROSOFT VERDICT

WHAT'S ONE OF THE HOTTEST games in Washington these days? Guessing when the D.C. Circuit Court of Appeals will rule in the Microsoft case. One contingent thinks the court will act soon—right after oral arguments end on May 17. It sees the Justice Dept.'s earlier attempt to appeal straight to the Supreme Court as pressuring the appellates to move. Others hold that the

court will rule near the June 7 anniversary of Judge Thomas Penfield Jackson's order splitting the company in two. Particularly if it reverses Jackson, the anniversary might be hard to resist.

Then again, those who follow the court closest place their bets on later in June. It's a highly complex case, notes Microsoft attorney Carter Phillips, and involves seven judges, rather than the customary three. "It's feasible right now, but I'd be surprised," he says. "That would be an extraordinary effort."

One thing most agree on, though: One or two earlier findings may be overturned. And early July is the absolute latest. That's when the clerks start heading off to other jobs, and judges go off on summer junkets—er, um, seminars. *Dan Carney*

THE RAG TRADE

A HARD BARGAIN AT LANDS' END?

AFTER NEARLY 40 years at the helm, Chairman Gary Comer has, it seems, put the Lands' End casual wear catalog retailer he founded up for sale. Sears Roebuck looked into acquiring it last fall, according to sources close to the situation, but it hasn't made an offer. Neither has Wal-Mart Stores or May Department Stores, which, the sources say, also had a look last year. While none of the companies would confirm discussions, it's clear that Comer, now 73, is looking for an exit strategy.

But why no one wants to go beyond a first date isn't so apparent. Lands' End has a profitable e-commerce operation, where sales rose 58%, to \$218 million, last



year. But the slowing prospects for e-retail may have tarnished its appeal. Or maybe Comer, who controls 55%, may want too high a price.

Sources say he's looking for \$50 to \$70 a share. (Shares currently trade around \$34, the same level as three years ago, even though last year's earnings fell 28% on overall sales of \$1.46 billion.)

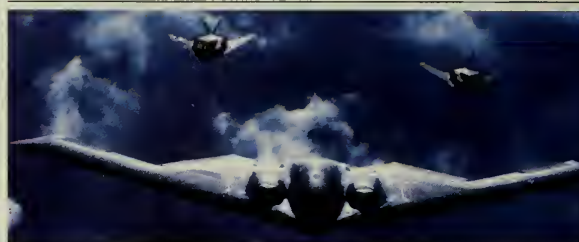
Meantime, there's some internal turmoil. Five Lands' End execs and four board members have left in the past year, indicating disagreement over the company's direction. But CEO David Dyer denies deeper problems: "Change is something you have to go through." Still, the biggest change will be yet to come, when Lands' End is finally sold. *Robert Berner*

TALK SHOW "Nobody can ignore the wishes of one-fifth of the world's population."

—Wang Hui, Beijing Olympic bid official, on news that China is a front-runner to host the 2008 Games

WILD BLUE YONDER

A NEW LEASE ON LIFE FOR THE B2 BOMBER?



B2 OR NOT B2, THAT IS THE QUESTION. AND IT'S DEFINITELY on the lips of defense manufacturer Northrop Grumman. The is its out-of-production stealth bomber, developed more than 20 years ago. The plane performed well in Kosovo but was shelved in 1999. With the Pentagon starting to shift its preparedness away from Europe and more toward Asia (page 5) where long distances make bombers a better bet than fighters, Northrop Grumman is offering to reopen its B2 production line in Palmdale, Calif. Industry sources say its influential backers include Deputy Defense Secretary Paul Wolfowitz.

The idea has a surprising opponent, however: longtime Northrop Grumman executive James G. Roche, President Bush's pick as Air Force Secretary. He fears the planes are obsolete and wants the Air Force to start developing a new bomber instead, according to the sources.

But more B2s could be turned out far faster than a bomber that's not yet on the drawing board. And while the B2s would run about \$1.5 billion each, the cost of developing a new bomber with advanced electronics and stealth could be, well, stratospheric. In the end, the question is whether the Pentagon needs outdated planes sooner rather than a high-tech successor later. The decision, which is ultimately up to Bush and his defense chief Donald Rumsfeld, will probably come later this year. *Stan Cro*

THE ECONOMY IS THE ECONOMY BOTTOMING OUT?

Some top execs think so. Here are some of their recent comments:

SCOTT MCNEALY CEO, Sun Microsystems, Apr. 1

"I see a bottom every time I change my 1-year-old's diaper. That's the only sure bottom I know. Anyone who is trying to predict doesn't know."

CARLY FIORINA

CEO

Hewlett-Packard

Apr. 18

"We are talking about this quarter being a bottom."

PAUL OTELLINI

Executive VP

Intel, Apr. 17

"We believe our PC-related businesses have bottomed out and are planning for a seasonally stronger second half."

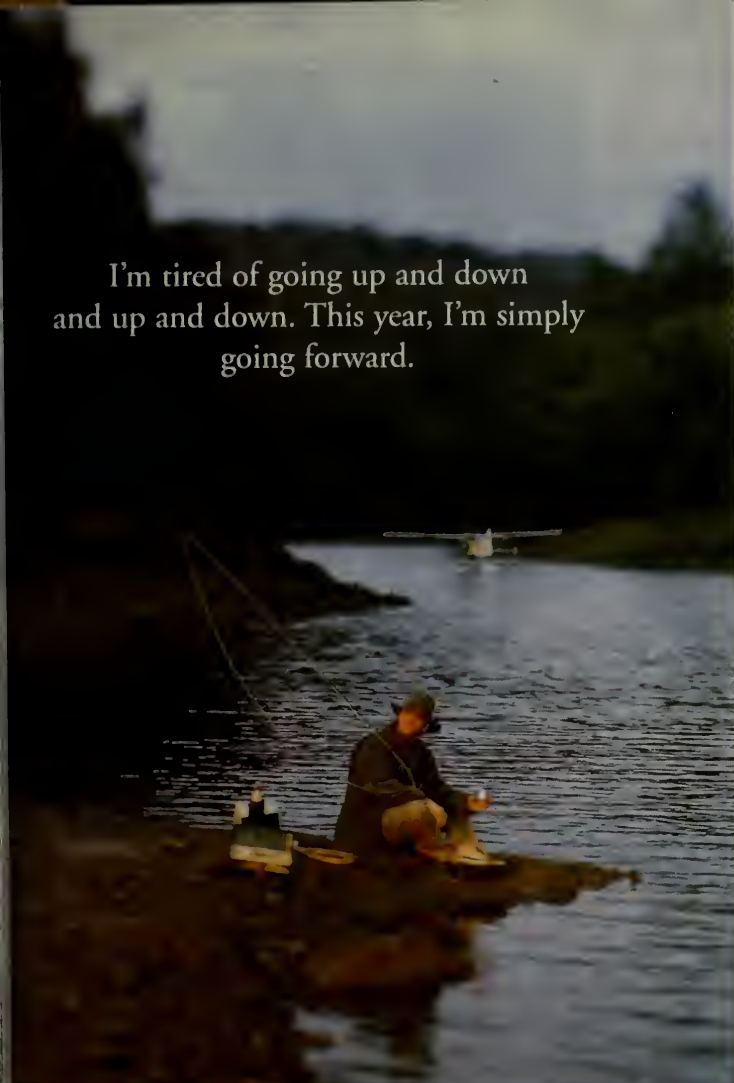
JERRY SANDERS

CEO, Advanced

Micro Devices, May

"The communications business is not recovering yet but the PC and computers business is now beginning slow recovery."

Data: Compiled by the Austin American-Statesman



I'm tired of going up and down
and up and down. This year, I'm simply
going forward.

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Up Front

IMAGE BUILDING

MISSISSIPPI COVETS A NEIGHBOR'S TEAM

MENTION THE STATE OF Mississippi, and most people think cotton fields and kudzu, not wired schools, high-tech manufacturing, and professional sports.

But officials in Jackson are working hard to cultivate a more urbane image for a state that has already slipped into recession and is perennially among the poorest in the nation. With the economy making their efforts especially urgent, they've scored a few victories: Japan's Nissan Motor will build a \$1 billion state-of-the-art auto plant; Governor Ronnie Musgrove has pledged to wire all public schools to the Net; and former Netscape CEO and Mississippi Jim Barksdale has

given \$100 million to literacy programs. Officials even managed to lure Spain's royal couple to come see Spanish artifacts in the state art museum.

But the real coup would be snatching away the New Orleans Saints from Louisiana. There's a good shot. Mississippi is promising a \$400 million, 65,000-seat stadium on the Gulf Coast within 45 minutes of downtown New Orleans. "Any interest from Mississippi would be welcomed," says a Saints spokesman, "but our priority right now is to stay in Louisiana." Officials there, adamant that they not lose the team, are scrambling to the defense. *Charles Haddad*

CHINA WATCH

A NEW BACKLASH AGAINST AN OLD ENEMY

SEETHING RESENTMENTS LEFT OVER FROM WORLD WAR II FADE slowly, if ever, as Japanese companies facing rising nationalism in China are finding out. Since news broke several months ago that an accident involving a Mitsubishi whose brakes failed had left a Chinese woman in a coma, the Chinese Consumer Assn. has received an avalanche of complaints against Japanese products. Press reports have charged Japan Airlines with making Chinese passengers spend the night aboard a delayed flight and Pioneer with using inferior replacement parts in an amplifier. And that's just this year—2000 had its share of anti-Japanism, too.

It's unclear whether Japanese companies in China are any worse than others. But worried about the impact of bad press on sales, they're responding by adding repair centers, opening complaint hotlines, and recalling products. Still, the Japanese are none too happy about it. Says Pioneer Shanghai's head of after-sales service, Pan Haiming: "Exaggerated reports in the Chinese media may have left the wrong impression that Chinese users are hurt. It's unfair to us."

For those unaware of the history: Japanese soldiers killed an estimated 300,000 civilians in Nanjing in 1937 and committed numerous atrocities during a nine-year occupation.

Alysha Webb



NANJING: Memories linger

SAINT: Go marching out?

DRAWN & QUARTERED



HALLS OF IVY

TRAINING SCRIBES FOR THE BIZ BEAT

THE '90S WERE A GODSEND to business and tech journalism. More than 100 publications were launched to cover the boom. And to help meet demand for writers, J-schools had to start turning out grads as savvy in numbers as previous ones were in politics.

More students need more teachers, so there's been a spate of endowments for business-journalism professorships. Such chairs lure well-known biz writers—Sylvia Nasar of *The New York Times*, for one—to teach their specialties and

enhance the schools' cache. In April, media king Michael Bloomberg gave \$1.5 million each to Columbia University and to Baruch College and \$585,000 to the University of California at Berkeley. Missouri got a \$1.1 million challenge last year, and Columbia and Washington & Lee each got \$1.5 million challenge in 1999. "Business journalism is hot," says Terri Thompson, director of the Knight-Bagehot fellowship at Columbia. "Journalists see it

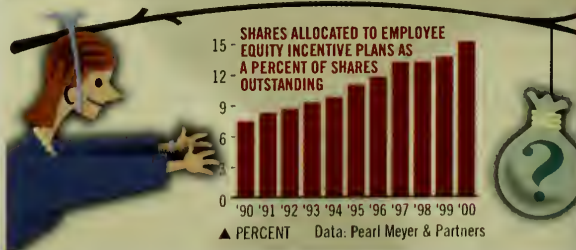
a career track." Next, the Reynolds Foundation may give up to \$1 million in various business writing grants, says President Steven Anderson. Enough to launch a lot more Sylvia Nasars. *Joan Ole*



THE BIG PICTURE

EMPLOYEE STOCK OPTIONS ARE STILL HOT

America's 200 largest corporations are allocating a record 15% of their shares to employee stock options, despite the poor showing of the markets. Experts expect the growth trend to continue in 2001.



FOOTNOTES U.S. households that bought portable electric generators: in 1999, **529,000**; in 2000, **730,000**



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THE HURDLES THAT JAPAN'S NEW PRIME MINISTER FACES

I agree with "A mandate for change in Japan" (Editorials, May 7). It really is a soft revolution, if we take Junichiro Koizumi's reform agenda at face value and if the new administration can swiftly implement all the reform measures without making any concessions to the Liberal Democratic Party's Old Guard. Japanese voters, fed up with the empty promises of successive LDP governments, welcome Koizumi's initiative but still are a bit skeptical about whether he can tackle all the problems singlehandedly. Koizumi was not elected Prime Minister by popular vote, but by the majority of MPs belonging to the LDP. Eventually, reformers risk being forced to compromise to LDP bigwigs. Also, reformers will face fierce resistance from bureaucrats who seek to preserve their alliances with LDP factions.

Hideki Kitamura
Nishinomiya, Japan

Koizumi may have a genuine chance to make substantive changes quickly ("Japan's reformer," Cover Story, May 7) because the LDP can't afford to give him the heave-ho. A cynic might conclude that the rust-encrusted party would rather defend its traditional perquisites than give the reformer the opportunity to do his job. But realpolitik may prove stronger with the winners: the Prime



Minister, the LDP, and most important Japan.

Michael G. Driv
Ichihara City, Jap

DEBATING RELIGION'S PLACE IN THE LOCKER ROOM

Spiritual growth and development as a Christian is a process that takes time ("God and man at Madison Square Garden," *News: Analysis & Commentary*, May 7). If an athlete incorrectly states something based on his study of the Bible, the misstatement should be treated as a "fumble" in that athlete's growth process. By sponsoring sports, Corporate America sponsors the display of athletic ability, not Biblical scholarship. Youngsters looking for role models who are "giants of faith" should have a wider range to choose from than athletics.

Reve' M. Pe
Albany, C

Jay Weiner's commentary was shocking. While it might be worthy to speak out against these athletes in prayer, the specter of promoting anti-Jewish attitudes must be condemned by everyone including NBA officials. John Rucker could not go away with insensitivity, nor should the Knicks.

William J. Le
National Direct
Organization of World Jew
Fogelsville, Pa

Jay Weiner's commentary was a real air ball. It's refreshing to see you National Basketball Assn. players spend time studying their faith and that not such players fit the role of the "tattlers and tough guy personas" as depicted "How bad is the NBA hurting?" (Sports Business, May 7). These pro players

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MAY 28, 2001 (ISSN 0007-7135) *** 3734
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*The 500-Year Delta and
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Corporate Leadership Isn't What It Used To Be. It's Much More.

The technological advances of the past few decades have fundamentally transformed business. In the process, they have also rewritten the rule book on corporate leadership. What are the new rules? What techniques, knowledge, and personal qualities are essential to effective leadership today?

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Readers Report

CORRECTIONS & CLARIFICATIONS

In "The numbers game" (Cover Story, May 14), a table incorrectly stated that the Securities & Exchange Commission was expected to revise its revenue-recognition guidelines.

In "How mutual funds come calling" (BusinessWeek Investor, May 21) Dobson Covered Call Fund misreported performance figures for year-to-date return. In the story and accompanying table, the correct figure should be -3.5%, not 5.1%, which is its return for April only.

eed to be applauded, not condemned, or actively practicing their faith.

Robert J. Milis
Apple Valley, Minn.

This is religion? This gets preferential tax treatment? Is professional sports part of the farce where millions of students spend school time playing basketball, hoping for a shot at 50 to 100 big-league opportunities each year while real value-producing businesses can't find the millions of workers they need?

Stephen Kay
Severna Park, Md.

As a consumer, I would not be turned off by a Mormon presence at the Salt Lake City Olympics or by rock stars or athletes who thank God for their success. However, I would be terribly offended by any business that tried to impose restrictions on an athlete's freedom of speech or freedom of religion.

Hannah E. Bond
Hamilton, Ohio

In religious matters, from a national standpoint, it matters not what is true or false. It is the right to believe and express that belief that our forefathers cherished when they discussed and passed the First Amendment.

Bruce D. Oliver
Oakland, Calif.

STABILITY IS THE IMF'S GOAL IN INDONESIA

It is incorrect to see failure in Indonesia ("The IMF should quit playing politics," International Business, May 7). In 1999-2000, macroeconomic stability was restored, the threat of hyperinflation firmly averted, food security assured, and foreign exchange reserves

rebuilt. Moreover, important steps were taken to recapitalize the banking system. The current dialogue with the Indonesian authorities has focused on how best to sustain the recovery and to build upon it.

The International Monetary Fund has acknowledged that its programs have attempted to accomplish too much too quickly. That is why the fund and its 183 members are moving to streamline the approach to conditionality. Indeed, stability is the whole point of recent Fund-supported programs, which your reporters deride.

Thomas C. Dawson
International Monetary Fund
Washington

A LONG-RANGE NUCLEAR PROGRAM NEEDS BREEDER REACTORS

"A comeback for nukes" is timely; and "Safe enough for your backyard?" rightly points out the advantages of building smaller nuclear plants (News: Analysis & Commentary, Apr. 23). However, the real development necessary to have a long-range nuclear program is to build breeder reactors. Uranium 235 is the isotope that fissions, but it is an extremely small part of natural uranium; only seven atoms in a thousand. The rest is uranium 238. A breeder reactor would convert uranium 238 to plutonium that we could burn. So a breeder reactor would burn nearly all the uranium. If we just burn uranium 235, our nuclear fuel will run out in about 100 years. If we convert uranium 238 to plutonium in breeder reactors, we can extend the life of the nuclear industry to 10,000 years or more.

Volney C. Wilson
Sister Bay, Wis.

Editor's note: In 1942, the writer directed the instrument group at the University of Chicago that designed and built the neutron detectors and the control and safety devices for the first chain reaction, supervised by Enrico Fermi.

AMERICA'S DANGEROUS SHORTAGE OF CAREGIVERS

A key element of the current difficulties stems from a dangerous national shortage of nurses and Certified Nurse Aides ("Nursing home care: Code blue," Social Issues, May 7). Perhaps no group works as hard under extremely difficult conditions as the dedicated caregivers in America's nursing homes. Federal and state policymakers should place on the policy front burner the task of finding, training, and retaining nurses and CNAs.

This is an essential step toward improving long-term care in America.

Dr. Charles H. Roadman II
President & CEO
American Health Care Assn.
Washington

WHY DO EUROPE'S STATION WAGONS RULE THE ROAD?

I was gratified to see that your review of estate cars featured so many European models ("Not your mother's station wagon," BusinessWeek Lifestyle, May 7). The reason that we Europeans "still haven't figured out how to make a decent cup holder" is that we consider such an item out of place in a vehicle. If you want to get from A to B, use a car. If you want to have a drink, go to a café—and indeed we Europeans have figured out how to make excellent cafés.

Susan Grossey
Cambridge, England

I was amazed at the omission of any mention of Ford's Taurus and Sable station wagons in your article. I've owned these cars ever since they came out in 1986. For me they are the ideal combination of utility, comfort, and economy. They're perfect for transporting my wife's concert harp and accoutrements.

John Eliason
Bloomington, Minn.

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Books

NICKEL AND DIMED

On (Not) Getting By in America

By Barbara Ehrenreich

Metropolitan Books • 221pp • \$23

DOWN AND OUT IN THE MIDST OF A BOOM

Close to one-third of all working Americans spent the late 1990s grinding away for wages of \$8 an hour or less. Many others, caught up in a great boom, may have imagined that people in this huge pool just weren't energetic or hard-working enough to make a decent living. In *Nickel and Dimed: On (Not) Getting By in America*, Barbara Ehrenreich asserts that this is far from true. "I grew up hearing over and over, to the point of tedium, that 'hard work' was the secret of success," she writes. "No one ever said that you could work hard—harder even than you thought possible—and still find yourself sinking ever deeper into poverty and debt."

Nickel and Dimed is an "old-fashioned," in-your-face exposé of how this other one-third lives. For her research, Ehrenreich, the left-leaning social critic and author of *Fear of Falling* and other books, left a comfortable life to labor alongside those in the slow-lane world of waitresses, nursing-home attendants, and housekeepers. In doing so, she followed in the footsteps of such writers as George Orwell, who in the 1930s chronicled the work lives of poorly paid Paris restaurant dishwashers, and Michael Harrington, whose 1962 *The Other America* inspired supporters of Lyndon B. Johnson's War on Poverty.

Ehrenreich's account is angry, amusing, and ultimately painful. But it falls short of ideal. Orwell brought his work to life by focusing on a few central characters. Ehrenreich, by contrast, introduces too many co-workers—none of them really memorable. Still, this important volume will force anyone who reads it to acknowledge the often desperate plight of Ehrenreich's subjects. And because she draws grim conclusions about their lot during a time of economic growth, the book raises scary questions about what will happen in a

less bustling, post-welfare-reform U.S.

During her three-month sojourn, the author avoided cities such as New York and Los Angeles, "where the working class consists mainly of people of color and a white woman with unaccented English seeking entry-level jobs might only look desperate or weird." Instead, she found positions in the suburbs and exurbs of Florida, Maine, and Minnesota. In each locale, she took the highest-paying job that she could find quickly. Except for waitressing, where part of the income came from tips, her hourly pay always exceeded the minimum wage: In Key West, Fla., she worked two different restaurant jobs and supplemented her income with a \$6.10-per-hour stint as motel housekeeper. In Portland, Me., she became a \$6.65-per-hour cleaning lady for a national maid service and also worked weekends as a \$7-per-hour nursing-home aide. In Minneapolis, she became a salesclerk at Wal-Mart, where her hourly pay was \$7.

A key finding: The working poor have little choice but to take more than one job at a time. The author tried mightily to keep costs low, living in cheap motels—\$245 a week in Minnesota—and driving a Rent-A-Wreck car. But even with no children to support, she couldn't make ends meet on one paycheck. The result was exhaustion: The long hours and hard labor "absorbed all my energy and much of my intellect."

Such fatigue, according to Ehrenreich, partly explains why there is little social unrest among low-wage workers. She insists that America's working poor are far from homogeneous, but she finds that they do share some characteristics: passivity and resignation. Few of the

people she encountered were interested in unionization, and even their vice were minor. When her co-workers wanted to "bust out," they didn't turn to riot or alcohol, but rather to their cars. Her housekeeper friends, for example, delighted "in pushing the pedal to the metal and terrorizing the elegant neighborhoods" where they toiled.

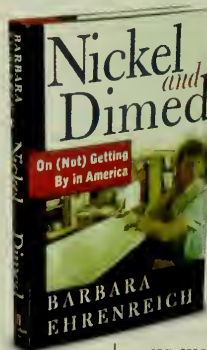
Working as a maid drove home to Ehrenreich the marginalization and dehumanization of the American poor. One company where she interviewed, Merry Maids, is the largest of the residential cleaning services that have sprouted in the past 20 years. In its advertising the company portrays its workers as paragons of industry, eager to get down on their hands and knees to clean floors. Meanwhile, she says, such outfits take great pains to limit the contact between clients and workers, making sure to rotate employees at each location so that individuals never emerge as sympathetic human beings in the eyes of clients.

Ehrenreich's descent into this underclass life filled her with a burning anger. She rails against a universe in which workers are banned from talking to each other, denied trips to the bathroom, forced to allow management searches of their purses at any time, and kept on their feet—or their knees—for hours on end with few breaks. She instructs us that many of these workers toil in a world few of

us would voluntarily enter. You don't have to be poor to have to clean up dirt, but for many low-wage workers living with filth is the rule, not the exception. Like Orwell, Ehrenreich fixates on sights and smells as her most odious memories. "Down there below knee level," she says, describing work as housekeeper, "you find elaborate dust structures held together by a scaffolding of dog hair; dried bits of pasta glued to the floor by their sauce; the congealed remains of gravies, jellies, contraceptive creams, vomit, and urine. Standards of work may have improved in the 20th century, but for the working poor, there is still a long way to go.

BY ANNE COLAMOSCA

Colamosca is co-author of *The Juda Economy: The Triumph of Capital and the Betrayal of Work*.



EHRENREICH FINDS THE POOR HAVE LITTLE CHOICE BUT TO TAKE ON MORE THAN ONE JOB

BY **STEPHEN H. WILDSTROM**

sh&you@businessweek.com

A ONE-TWO PUNCH FOR SHUTTERBUGS



Adobe's hobby version of Photoshop and Nikon's new scanner make a potent combination

Hobbyists who want to get into a digital darkroom and manipulate photos on their computers have long faced an unpleasant choice. They could settle for such inexpensive and limited programs as Adobe PhotoDeluxe, Microsoft PictureIt, or ArcSoft PhotoStudio. Or they could take the plunge and go for the pros' choice, Adobe Photoshop—for \$600.

Adobe eased the pain of Photoshop's price tag with a "limited edition" that took away some of the more arcane features and about \$500 of the cost but did nothing to flatten the program's steep learning curve. Now it has introduced the new Photoshop Elements, available for about \$90, for Windows or Mac. The price break is nice, but even more alluring to hobbyists, who regularly drop hundreds of dollars on lenses and gadgets, is the ease with which Elements helps anyone turn digital snaps or scanned photos into better pictures for print or online use.

The look and feel of Elements will be familiar to anyone who has used Photoshop, but there are some critical differences. On the left side of the screen is a panel of picture-editing tools, such as paintbrushes and a color-selection eyedropper. On the right is a collection of "palettes" that handle a variety of chores, such as selecting brush styles and recording a history of actions so that you can always revert to an earlier version of your work.

Palettes are a powerful tool in Photoshop, but too many of them can clutter your screen. The pros often use two monitors—one for the picture and one for the tools. Elements offers an easier solution: a series of tabs across the top of the screen that open and close palettes as needed. Two new palettes are helpful to nonexperts. The Recipes palette gives step-by-step instructions for common tasks, such as correcting color balance or adding text to a picture. And when you select a tool, information on its use pops up in the Hints windows. These helpers are useful to beginners, but unlike the pesky Office Assistant in Microsoft Office, they are unobtrusive.

Elements lacks a number of Photoshop features aimed at pros, including sophisticated tools to prepare pictures for commercial printing and video. Elements' techniques for creating complex composite images are also limited. But for those more interested in improving the appearance of their pictures than in the calendars and T-shirt projects that low-end photo programs specialize in, Photoshop Elements is a solid choice. And I commend Adobe Systems Inc. for including something sadly rare in consumer software: a comprehensive printed manual.

MORE PIXELS. Before you can edit, you need to get your picture into the program. That's where a new Nikon Corp. product comes in. Digital cameras get a lot of buzz, but many serious photographers prefer film, both because they have a big investment in gear and because film produces images far better than the best digital sensors. For the serious amateur, the Nikon Coolscan IV ED scanner for Mac or Windows can bridge the gap from film to digital. At \$900, it's not intended for casual use, but for serious work there's no alternative to a dedicated film scanner. The Coolscan produces high-resolution images—nearly 11 million pixels, compared with 3 million in a good digital camera—from 35mm negatives, film strips, or



slides. The scanner has built-in software to clean up scratches and dust and can even restore badly faded color images.

Coolscan can be a bit of a pain to use. The desktop software that manages the scanner is clunky, and feeding a film strip requires that you insert it into a slot just right. But the results are terrific, allowing quality enlargements far beyond the dreams of digital cameras or lesser scanners. Those images do, however, make for files of up to 50 megabytes per picture. You'll want a fast computer with lots of RAM and a big hard drive to work with them.

Digital photography has been a great success at two ends of the spectrum, pros and the point-and-shoot mass market. New hardware and software tools make the digital darkroom a lot more accessible to the hobbyist in the middle.

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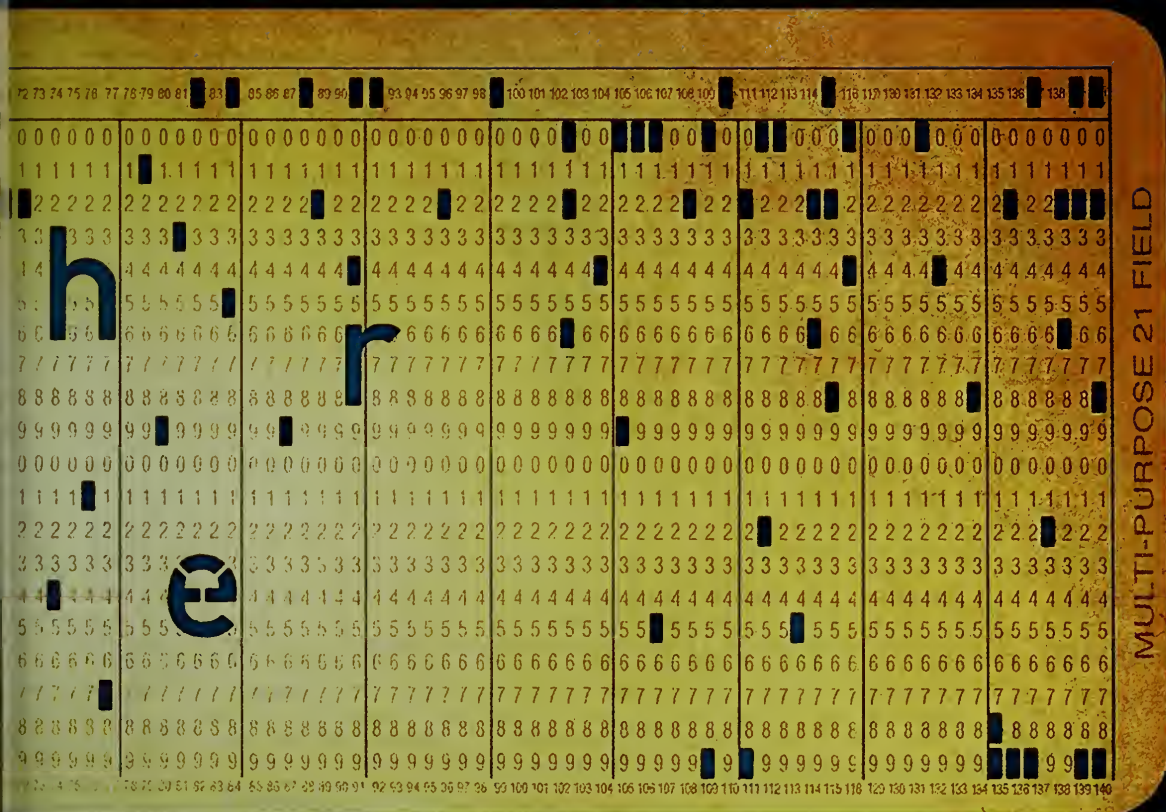
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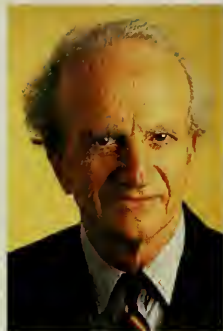
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BY GARY S. BECKER

HOW RICH NATIONS CAN DEFUSE THE POPULATION BOMB



ACCESS:
They should open their borders even more to poor countries with high birthrates—and give the greatest priority to skilled workers

While world population has doubled during the past several decades to more than 6 billion persons, birthrates in many countries have fallen to unprecedented low levels. The result is a demographic divide between nations with high and low rates of population growth that will have enormous economic and political significance.

Virtually all high-income countries, and a few poorer ones, especially China and Russia, have fertility rates that are too low to fully replace their populations. The average is only a little above one child per woman during her lifetime in Spain, Italy, Russia, and several other nations. Even in the U.S., which has the highest fertility rate among rich nations, women give birth to only about two children in their lifetimes.

Birthrates are notoriously difficult to forecast, but the persistence over several decades of low fertility in so many countries and regions of the world strongly indicates that their populations will eventually fall. As a result, overall world population will grow much more slowly during the next several decades than predicted by population scaremongers.

In the recent report *World Population Prospects*, U.N. demographers conceded after repeated denials that fertility rates below replacement levels are not a passing phenomenon. They recognized that every nation that had low birthrates during the 1980s continues to do so. They were joined in the 1990s by other countries with birthrates that dipped below replacement.

EFFICIENT REMEDY. The picture is different in most very poor nations, including all of Africa and most of South and Central America, since their much higher birthrates are causing their populations to grow rapidly. This difference in population growth between rich and poor nations will widen further the gap in per capita incomes between developed and other nations. Indeed, faster population growth in less developed regions contributed to the considerable widening of world income inequality during the past couple of decades.

An efficient remedy for this population divide would be for many men and women in countries with low incomes and growing populations to move to those with high incomes and stable or declining populations. The recent estimates from the U.N. show that developed regions absorbed about 20 million immigrants from poorer nations during the last decade of the 20th century. This global shift contributed about half the growth in the populations of richer nations, although Japan

has refused to accept many immigrants, despite the prospects in that country of a rapidly falling and aging population.

Immigration to Western Europe was especially important and accounted for more than 70% of its population growth during the past decade. The U.S. absorbed almost as many immigrants as did Europe, but immigration contributed a smaller part of its growth, since American birthrates are higher than Europe's. In addition, many persons entered both the U.S. and Europe illegally, so that the total contribution of immigration to population growth in both regions was even larger than official figures indicate.

TAXPAYERS' FEARS. Still greater emigration from poorer to richer nations would help alleviate the continuing inequality among the world's economies created by the higher population growth of the less developed world. But rich nations are reluctant to open their borders any wider to immigrants because many powerful interests almost always oppose large-scale immigration. Trade unions fear that competition from immigrant labor will lower wages of their members. Many taxpayers believe the welfare state attracts immigrants who mainly seek government benefits and contribute little to production. Other groups worry about the effect of immigration from Third World countries on the racial and ethnic mix of their populations.

Many of these arguments could be countered. Host nations gave greater priority to young and more skilled immigrants who work hard and who contribute much more in taxes than they receive in benefits. However, even skilled immigrants are not readily welcomed, as seen from the political difficulties in expanding the H-1B American visa program, which gives temporary visas to high-tech personnel.

These obstacles ensure that legal immigration will not solve the conflicts that arise from different rates of population growth. The problem would be greatly reduced if poorer nations promoted greater economic growth through encouraging entrepreneurship and through greater investments in human and physical capital. Birthrates invariably fall rapidly when countries have faster economic growth and expanding education, especially the education of women.

Unless immigration and population policies change, conflict between the economic haves and have-nots will inevitably increase as growing numbers of young men and women from the underdeveloped world try to gain access to the opportunities in rich nations.

Gary S. Becker, the 1992 Nobel laureate, teaches at the University of Chicago and is a Fellow of the Hoover Institution.



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What do you have to say?

BY GENE KORETZ

SMALL BUSINESS SEES BLUE SKY

Its economic worries have abated

The fears of experts that the economy was slipping into recession were recently soothed by news that consumer sentiment improved in early May. But consumers aren't the only ones with rising spirits. The National Federation of Independent Business reports that its small-business optimism index edged up to 98.4 in April, nearly two points above its January low.

"There's no question that small-business owners are currently feeling bet-

owners plan to expand payrolls in coming months. That's down from a high of 22% in late 1999, but it's still a respectable number historically.

Perhaps the most noteworthy development is the fact that the share of respondents with hard-to-fill openings came in at 26% for the second month in a row, after 17 months above 30%. The drop in this key labor market indicator, says Dunkelberg, strongly suggests that the unemployment rate will hit 5% by the end of the current quarter.

The news on inflation was positive. While a relatively high 32% of small businesses raised compensation in recent months, a mere 17% plan to do so in the next three months, the lowest number in over two years. At the same time, both reports of recent price hikes by owners and plans to implement future increases remained restrained.

On the credit front, the news was also encouraging. In spite of a reported tightening of lending standards, just 3% of respondents said they found loans harder to get, one of the lowest readings in the survey's history.

All in all, says Dunkelberg, the latest survey results should dispel fears of a near-term economic contraction. "For the next six months at least, modest growth seems assured," he says.

ECONOMIC STORM CLOUDS MAY BE PARTING



ter—particularly about the overall economic outlook," says NFIB economist William C. Dunkelberg.

According to the NFIB's latest monthly survey, a net 10% of respondents felt that the economy would strengthen over the next six months, the highest number since November, 1997. By contrast, just a few months before the 1980 and 1990 recessions, the readings were a negative 37% and 27%, respectively.

The rise in optimism about the economy doesn't mean that the small guys think their own businesses are about to take off or that it's time to boost investment. Although their profit and sales performances improved last month, only 13% expect higher sales in coming months (vs. 20% in April, 2000). And just 10% think it's a good time to expand facilities, the lowest number since 1993. So far this year, both capital outlays and spending plans have been running below year-earlier levels.

Meanwhile, despite a perceptible easing in small-business job markets, labor demand remains relatively firm. Actual hiring rose in April after languishing for several months, and a net 12% of

THE GREENBACK'S FOREIGN SERVICE

Adopting the dollar is no panacea

Dollarization—replacing a nation's money with the dollar or another big-country currency—is a hot topic these days. Ecuador recently shifted to greenbacks, and El Salvador and Guatemala are doing so this year. Advocates of dollarization say it is better than simply making your currency convertible into another currency, as Argentina has done, because it allays fears that nations will resume printing their own money to finance deficit spending.

But the evidence of the gambit's merits is sparse. Only two decent-sized nations—Liberia and Panama—have ever adopted another nation's currency completely, and Liberia shifted to its own currency in 1982. The 11 other "dollarized" countries are flyspecks like Monaco, Liechtenstein, and Andorra.

Proponents often point to Panama, which has long used the U.S. dollar as money and boasts growth averaging 5.3% and inflation averaging 2.4% since the late 1950s. But a new study by Se-

bastian Edwards of the University of California at Los Angeles notes that Panama has also benefited from an almost uninterrupted series of International Monetary Fund bailouts since 1973. He finds that economic growth in Panama and smaller dollarized nations has actually been lower than in similar nations with their own currencies.

Edwards isn't necessarily against dollarization—he thinks it was the right step for Ecuador, for instance. But he feels its fans need to acknowledge the relative ignorance about it. "Advocating dollarization," he says, "is like recommending a new drug that has been subject to very limited clinical trials."

By Peter Co

FEWER SENIORS IN THE 1990s

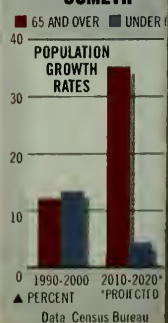
But their ranks are set to explode

Although the elderly's share of the population has been growing rapidly in virtually all advanced nations, it turns out that it has been declining a bit in the U.S. Based on last year's headcount, the Census Bureau reports that the 65-and-over contingent during the 1990s actually grew more slowly than those under 65 for the first time in the history of the decennial census.

The apparent anomaly reflects low birthrates in the late 1920s and early 1930s and a surge in U.S. legal and legal immigration in the 1990s. But it won't last. Between 2010 and 2020, the decade in which baby boomers start to hit 65, demographers project a 35.8% increase in the ranks of the elderly—vastly higher than the increase in the under-65 population. The growth of the latter group is currently pegged at just 4.2% but will undoubtedly be revised up a few percentage points.

These numbers highlight the demographic honeymoon U.S. entitlement programs are enjoying. Within a dozen years, the budget surplus—if there still is one—will feel relentless pressure from the health and retirement needs of a tidal wave of seniors that will last for decades.

A TIDAL WAVE COMETH



SOMETHING ELSE FOR GREENSPAN TO WORRY ABOUT

Capital-spending cuts are idling factories, prompting another Fed move

U.S. ECONOMY

Consumers are still out shopping, and builders are using more construction supplies to put up new homes. Yet manufacturing remains in the grips of recession, with output sinking and layoffs rising. What gives?

Blame these apparent inconsistencies on the complexities of this business cycle, many of which are related to the new influences of technology—both positive and negative. This slowdown began when consumer spending cooled, forcing businesses, especially auto makers, to make adjustments in their inventories.

Now comes Phase Two: Companies are cutting costs and reining in outlays for equipment. That means the inventory problem has shifted to the makers of high-tech products—computers, semiconductors, peripherals, and telecom equipment—and these industries are slashing output. It also means that capital spending will be a big drag on second-quarter economic growth.

The problems of the capital-goods sector were very much on the minds of Federal Reserve policymakers when they met on May 15. As expected, the Fed cut its federal funds rate by a half-point, to 4%. The Fed's accompanying statement noted that consumer spending on housing have held up well, although activity has slowed recently. However, it said that investment in capital equipment "has continued to decline" and that weak profits and uncertainty over the outlook "seem likely to hold down capital spending going forward."

THE FED HAS TRIMMED rates by 2½ percentage points in only 4½ months, the most aggressive easing ever by Chairman Alan Greenspan and one of the boldest series of cuts ever. But the Fed probably isn't finished, since policymakers remain more concerned about economic weakness than about inflation pressures.

Indeed, the statement downplayed both the first-quarter drop in productivity and inflation worries, saying that "with pressures on labor and product markets easing, inflation is expected to remain contained" (part). However, the likelihood of more intermeeting rate hikes seems to be waning. Unlike the statement following its March meeting, the Fed did not mention

the need to "monitor developments closely," words that have often preceded moves between meetings.

Further signs of economic weakness will most likely justify another Fed move at its June 26-27 meeting. And softness will probably remain centered in manufacturing. The inventory overhang in the vehicle sector, just 4% of factory output, started the manufacturing downturn last fall. The drop in auto production subtracted 0.9 percentage points from real GDP growth in the fourth quarter and 0.7 points in the first quarter.

Now it's tech's turn to deal with excess inventories and output cuts. Total industrial production fell 0.3% in April, its seventh decline in a row. Factory output alone slipped 0.3%, also the seventh consecutive drop. But production of tech equipment fell 1% in April, the fourth big drop in as many months (chart), and tech output in the first quarter was revised down sharply.

THE GREAT DEBATE right now is whether this sector, some 10% of manufacturing, is in such dire straits that it will drag down the rest of the economy. On the surface, the answer seems to be no. Even excluding the steep declines in tech output so far this year, factory production would still be down by almost the same amount for each month, suggesting that the output weakness goes beyond just tech equipment.

The rapid tech slowdown, however, is an example of how swiftly companies now react to shifts in the economy. Greenspan has noted that better information and new technologies have shortened the lead time for equipment delivery and enabled companies to adjust their capital spending more quickly to demand shifts. So inventory adjustment of tech gear should take a matter of months, not quarters.

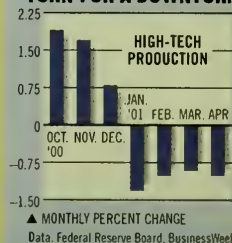
This compression makes the adjustment feel more severe and results in a sharp rise in layoffs, which shakes consumer confidence. So, too, warnings about profit shortfalls, such as Cisco's in mid-April, cause jitters among investors. That's why, even though the inventory correction directly affects just a small segment of the economy, it has large spillover effects.

Luckily, the adjustment to stock levels, especially in the tech sector, is already well under way. Total

THE FED: INFLATION WILL 'REMAIN CONTAINED'



NOW IT'S TECH'S TURN FOR A DOWNTURN



Business Outlook

business inventories fell 0.3% in March after a 0.4% drop in February. Stock levels of tech equipment plunged 3% in March on top of a 0.8% loss in February. The inventory drop, coupled with a 2% gain in March shipments, pushed the inventory-sales ratio from 1.21 in February to 1.15 in March. That's a good start to readjusting inventories, but the ratio is still above the 1.03 record low of September, 2000, suggesting production will fall further in coming months.

Keep in mind that tech manufacturers aren't just adjusting to demand problems but also face overcapacity in their own sector. New production capacity was growing at a 50% annual rate in mid-2000. For April, the rate had fallen to about 20%, and it will go lower, since companies need to balance their supply capabilities with the new, slower pace of demand.

HOW MUCH WILL DEMAND SLOW? Consumers hold the key. So far at least, they remain committed to spending, though at a more modest pace. Retail sales jumped 0.8% in April, but the March data were revised down to show a 0.4% drop instead of the 0.2% loss originally reported. Retail buying began the second quarter 2% above its first-quarter average, suggesting that real consumer spending is growing much more slowly than the 3.1% gain of the first quarter.

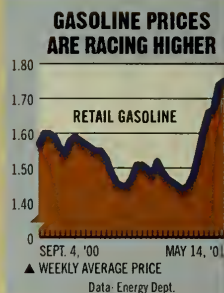
The April retail increase, however, was better than expected and bolsters the argument that consumers

can keep this expansion going. Higher gasoline sales—mostly the result of rising prices—contributed one-tenth of the total percentage advance in April.

Although the Fed did not mention costlier energy explicitly in its May 15 statement, it is always on Greenspan's list of concerns, since it boosts production costs and cuts household buying power. In early May, the average price for a gallon of gas was \$1.74, up from \$1.44 in March (chart), and prices are expected to keep rising this summer.

Higher fuel prices are also pushing up the top-line inflation numbers, but there is scant evidence that companies are able to pass along their higher costs to customers. Total consumer prices rose 0.3% in April; they are up 3.3% from a year ago. Core prices, which exclude food and energy, increased 0.2% in April, for a slower yearly gain of 2.6%.

One of the key differences in this business cycle is that low inflation is giving the Fed the room it needs to act aggressively. Now that the economy is safely past Phase One, the steep rate cuts, already in the pipeline, will provide strong support against the negative effects of Phase Two and pave the way for stronger growth.



SPAIN

THE INFLATION FIGHTERS GET NO HELP FROM BRUSSELS

The European Central Bank's surprise rate cut on May 10 may be felt differently in Spain than in Germany, where economic data have turned sharply weaker. Lower rates could complicate Spain's efforts to keep inflation under control.

Spain's economy has cooled off from its 4%-or-better growth rate of the past four years, but it's still hot enough to stoke wage and price pressures. The April consumer price index rose 4% from a year ago, one of the fastest inflation rates in the euro zone. Even excluding energy and food, the rate is 3.4%, fueled by service prices. Overall inflation is well above the April euro zone average of 2.9%, which itself is

above the ECB's 2% ceiling (chart).

Moreover, wage growth continues to pick up. Some three-fourths of Spain's negotiated-wage agreements are indexed to inflation. Overall contractual wages in February rose 3.8% from a year ago—up from a 3.3% pace for all of last year—and unemployment continues to fall. Joblessness at 13.4% is the highest in the euro zone, but that's also Spain's lowest rate in over two decades.

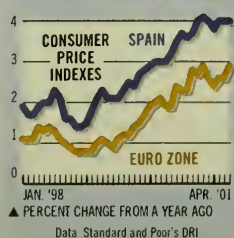
The economy will have to slow further in order to ease wage and price pressures. Spain's central bank estimates that first-quarter real gross domestic product grew a brisk 3.5% from a year ago. The official

data are due on June 20.

The global slowdown, while likely to retard labor-market improvement this year, nevertheless arrives at a favorable time for Spain. Softer foreign demand is cutting into Spanish exports, especially with its euro zone trading partners. Consumer demand is also slowing, since job growth is not as strong as it was this time last year. As a result, the government has lowered its growth forecast for 2001, to 3.2% from 3.5%, although that pace would still be faster than the expected euro zone average of 2.2%.

With the ECB in a rate-cutting mood, inflation-fighting will be an internal battle for Spain. That puts the onus on the Spanish government to press ahead with fiscal consolidation and labor-market reform to quell wage pressures.

INFLATION IS FAR ABOVE THE EURO-ZONE AVERAGE





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MORE OOMPH FOR ENERGY

With the gas crunch, the White House may get closer to the policy it wants

Who would have predicted it? Four months into his term, George W. Bush is earning his spurs in an unlikely role: He is a master of disaster.

When the economy began to weaken, the White House was ready. Bush stoked the public's economic anxiety to build support for a tax cut that had languished at barely 50% support in the polls. The result: House-Senate conferees are now putting the finishing touches on a \$1.35 trillion tax bill that gives the President much of what he wanted.

Now, Bush and Vice-President Dick Cheney are repeating the strategy. They're warning of an energy "crisis" to win backing for an ambitious multiyear energy policy. Even the plan's architects concede it does little for short-run dislocations. "This is a long-term problem," says White House economic coordinator Lawrence B. Lindsey. "It is not something we can wave a magic wand and solve."

Still, Bush's approach to the crunch bears a close resemblance to tactics used in the tax fight. Step One: Declare a crisis. Step Two: Blame "eight years of neglect" by the prior Administration. Step Three: Promote a long-term agenda that transcends the immediate problem. Step

Four: Brand opponents as naysayers.

Will it work the second time around? While the White House would like to trigger the same kind of stampede it used in the tax battle, the outcome of the energy debate may be less of a clear-cut victory for Bush. Congress stands to be a lot more assertive in shaping a response to the energy mess. And despite the slim GOP majority, Republicans won't rush into a lock-step embrace of Bush's blueprint.

CUSHION. That's because lawmakers view energy through a regional rather than an ideological prism. Northeast Republicans, led by Maine Senator Susan M. Collins, insist the policy must reflect more conservation con-

HOW THE BUSH-CHENEY ENERGY BLUEPRINT MAY CHANGE

DRILLING ON FEDERAL LANDS The Administration wants to open pristine wilderness areas to new exploration. Congress may allow that in some areas, but lawmakers will still balk at the Arctic National Wildlife Refuge.



REGULATORY STREAMLINING To get more power plants on line, Team Bush will try to accelerate the review process for building plants and transmission lines. The folks on the Hill will likely go along, if environmental safeguards aren't too badly compromised. One flash point: Western conservatives don't like Fed use of expanded eminent-domain authority to override state and local powers.



erns. Western Republicans think more help is needed to cushion California's sky-high prices. And coastal-state GOP governors—such as Florida's Jeb Bush—now to fight offshore drilling.

Still, sounding the alarm can't hurt—and many agree with Administration warnings about energy dependence and

inadequate infrastructure. Economists say that soaring fuel bills pose big risks for any rebound. Indeed, higher energy costs could wipe out the \$300 most people would get over the next two years from a tax cut.

But it's unclear how long the current squeeze will last. Higher prices have already begun to bring supply closer in line with demand, as oil and gas producers boost output.

In fact, by mid-May, U.S. crude-oil inventories were at their highest level since August, 1999. Sky-high electric rates have also spurred a wave of power-plant construction, with the North American Electric Reliability Council, a national oversight body, projecting that capacity additions will grow at 2 to 3 times the rate of demand over the next several years.

Surprise: The market works. But if that's the case, what's the rationale for the Administration's energy strategy, unveiled by the President on May 17 with a splashy appearance at a St. Paul (Minn.) alternative-energy plant? Bush hopes to leverage the crunch to shift the policy balance from the GOP's environmental foes to his pro-development friends.

Indeed, the Bush-Cheney plan is an amalgam of pro-production ideas that Hill Republicans have long advocated. Among them: streamlining environmental reviews to speed plant construction, boosting nuclear and coal-fired power plants (page 82), building easier siting of electrical lines and gas pipelines, and opening the door to more oil and gas exploration on federal lands.

Not surprisingly, it's all boffo to industry. Even those who agree that Bush

may be playing up energy woes a bit to advance his agenda don't see the harm if he moves the country toward better policies. "He's striking while the iron is hot," says Fadel Gheit, a petroleum analyst at New York's Fahnstock & Co.

Bush's supply-side emphasis "is the right policy," according to John Rowe, co-CEO of Exelon Corp., the nation's largest nuclear utility. Adds John D. Correnti, CEO of Birmingham Steel Corp.: "You've got to make a decision between the environmentalists

and what's good for the country."

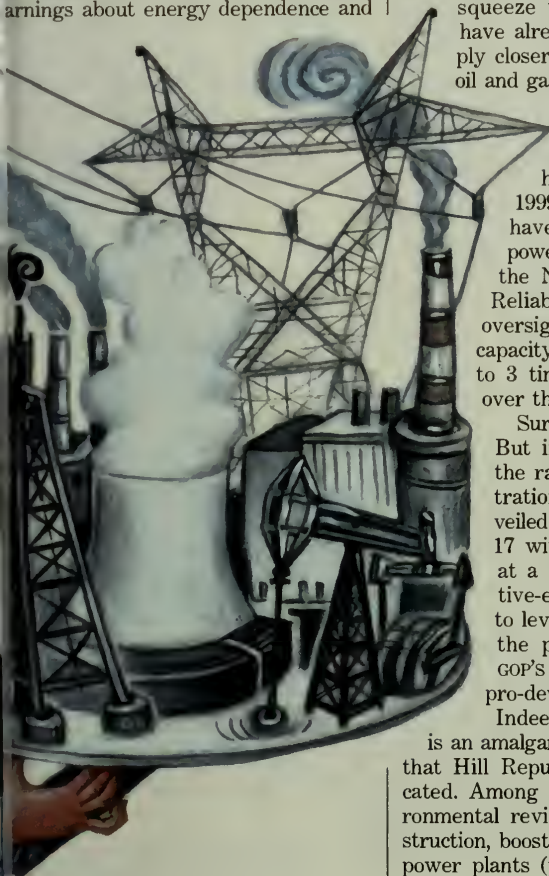
Still, the rising public perception that his team is environmentally insensitive has compelled the President to boost some energy-efficiency measures to his plan. The proposal now includes tax credits for hybrid-powered cars and renewable energy, agency studies of efficiency guidelines for buildings and appliances, cuts in government fuel use, and a directive to the Transportation Dept. to weigh stricter auto fuel-economy standards (page 36). But since many of the steps are modest or simply feasibility studies, Green activists aren't mollified. "The energy crisis is being whipped up as an excuse to roll back environmental regulations," says Sandra Schubert, legislative counsel for Earthjustice Legal Defense Fund.

BEYOND BASHING. So how will Hill Democrats respond to the Administration's proposal? Party leaders plan to reprise the populist rhetoric that they used in the tax fight, this time in an attempt to tag Bush and Cheney as tools of Big Oil. On May 15, House Minority Leader Richard A. Gephardt (D-Mo.) preemptively unveiled his own plan. Its key elements included temporary caps on wholesale electricity rates for California, tapping the Strategic Petroleum Reserves to smooth oil-price spikes, stiffer auto mileage rules, loads of tax credits for energy efficiency and alternative sources, and an antitrust probe of oil-company price fixing.

Nevertheless, moderate Democrats believe that to play a constructive role, the party must meet the White House halfway. "I don't think it's enough for us to just bash Bush and Cheney as 'bad oilmen,'" says Representative Adam Smith (D-Wash.). Centrists want more money for efficiency tax credits and expanded federal R&D on clean technologies—which could add billions to the tab.

So what's the outlook for the Wildcatter-in-Chief's proposals? The noisiest fight will swirl around proposals to drill in federal wilderness. That could doom plans to open the Arctic National Wildlife Refuge to exploration. But in a compromise, access to other federal lands might be increased (page 84). "We are shooting ourselves in the foot" by keeping such reserves off limits, says Robert J. Allison, chairman of Houston's Anadarko Petroleum Corp. "We can [extract oil and gas] in an environmentally sensitive way."

When it comes to tax incentives, Congress is likely to see Bush's opening bid—and raise him a ton. With a push from Democrats and conservation-minded GOP moderates on both coasts, a raft of Green tax credits may be added to the White House blueprint. "Energy efficiency has to be a significant part of the



INCENTIVES The White House credits for hybrid cars and ble energy sources. Dems will add tax breaks for d solar producers—and for orpion cuts. Oil-state Re-ns will try to expand write- exploration and drilling. des will see their suggestions if they swell the cost of the energy bill.



GAS GUZZLERS In a sop to enviros, Bush and Cheney will commit to studying tougher fuel-economy standards. Democrats' calls for mandated increases are a long shot with Detroit reeling. Instead, the Dems may press for a crackdown on the games Detroit uses to meet current standards.



equation," says Representative Greg Ganske (R-Iowa). But prospects for tax breaks for oil and gas drillers are dicier. With polls showing a strong current of public concern about oil-company "profiteering," Bush and Cheney opted to steer clear of the issue.

The price could grow even larger if Republicans, led by Senate Energy Committee Chairman Frank H. Murkowski of Alaska, get their way. Murkowski, for one, wants to reduce U.S. dependence on foreign oil by 50% by 2010, mainly through tax incentives for construc-

tion of power plants and refineries.

In the end, Congress is likely to give Bush a decent chunk of what he asked for—and lots of things he didn't. The result could be a policy pick-me-up for an energy industry beleaguered for two decades. It could be a nice tonic for the Oil-Patch President, as well. Sure, the Administration must make it past potential crises looming this summer, from a further spike in gas prices or continued turmoil in California's electricity meltdown. But if he can pass a package by fall—when market forces start to drive

power bills down, the result could be another case of Bush overcoming an unforeseen challenge—and confounding foes in the process.

By Lee Walczak, with Lorraine Woellert, Rich Miller, and Richard Dunham in Washington; Peter Coy in New York; Christopher Palmeri in Los Angeles; and bureau reports

BusinessWeek online

For more coverage of energy issues go to www.businessweek.com/today.htm.

COMMENTARY

By David Welch

FUEL STANDARDS: HOW TO PLUG THE LEAKS

With gasoline prices soaring above \$2 a gallon in many places, should fuel-efficiency standards for America's cars and trucks be raised? Many Democrats and environmentalists are clamoring for a hike, a bipartisan group of senators has proposed forcing gas-guzzling trucks and sport-utility vehicles to meet the higher mileage standards set for cars, and even the Bush Administration has been backed into asking the Transportation Dept. to look into stiffening standards.

But forget about the brewing debate. The auto industry is struggling, and this Administration is intensely antiregulatory. So there's little chance that current mileage standards will go up.

Does that mean Washington can do nothing to bring about a boost in the fuel efficiency of U.S. cars and trucks? Hardly. A great deal of gasoline could be saved—and carbon dioxide emissions reduced—by more strictly enforcing the rules now on the books. As it is, a host of tricks allows carmakers to skirt current standards. "If you closed all of the loopholes, we could save hundreds of millions of barrels of oil and cut hundreds of millions of tons of global warming pollution every year," says Dan Becker, director of global warming policy for the Sierra Club.

GOOSING AVERAGES. How so? The current standards, known as CAFE, for corporate average fuel economy regulations, were enacted back in 1978. Each auto maker is supposed to achieve an average of 27.5 miles per

gallon for its fleet of cars as a whole, and 20.7 for its truck fleet overall.

But what is a truck, and what is a car? The answer is hardly clear. SUVs and minivans have always been considered trucks for CAFE purposes, which wasn't much of an issue back in 1978 when there weren't many on



TRUCK—OR CAR?

These popular models are classified as trucks—and subject to lower MPG standards—even though they're built on car chassis

CHRYSLER PT CRUISER

FORD ESCAPE

LEXUS RX 300

TOYOTA

HIGHLANDER

HONDA CR-V

the road. But as soaring sales of gas-hungry SUVs have made it difficult to meet the CAFE standard for trucks, some carmakers have begun redefining cars as trucks. Since cars get better mileage, that helps improve the overall performance of their truck fleets.

Just look at the boost Daimler-Chrysler got when it was able to certify its popular PT Cruiser as a truck. Built on the same chassis as a Neon small car, it gets 25 mpg—well

above your average truck. Thanks to the 92,000 PT Cruisers sold last year, Chrysler was able to sell another 90,000 Dodge Durango SUVs—which eke out just 15 mpg—without busting its overall 20.7 mpg truck limit.

Auto makers can also benefit by selling flexible-fuel vehicles—trucks that run on either gasoline or ethanol fuel. For CAFE calculations, they're allowed to count the 30 to 40 mpg those vehicles get when they use ethanol, rather than the 20 mpg they get with gas. Problem is, with just 110 ethanol stations in the U.S., only a few of the 630,000 flexible-fuel vehicles sold ever use ethanol. The National Highway Traffic Safety Administration estimates this allows the Big Three to goose the average truck fleet fuel economy by up to 1.2 mpg annually.

Then there's perhaps the biggest game of all. The fuel economy numbers used in calculating CAFE standards bear no resemblance to real world driving conditions. Derived from laboratory tests, they're roughly 15% higher than what vehicles get when they're actually on the road. So U.S. cars burn an extra 1.1 million barrels of oil a day, or more than 400 million barrels a year, than the CAFE levels imply they ought to.

Of course, little of this is new, and carmakers are quick to point out it is all perfectly legal. Indeed, the NHTSA signs off on many of these games. Maybe it's time they stopped.

Welch covers the auto industry from Detroit

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CHRIS GALVIN SHAKES THINGS UP—AGAIN

Can his latest overhaul revive Motorola's standing in the wireless biz?

It's difficult to overstate how badly Motorola Inc. has been beaten up in the mobile-phone market by Finland's Nokia and other rivals over the past few years. Once the dominant mobile-phone maker in the world, Motorola has seen its market share shrivel as it has misread consumer tastes, alienated telecom companies with its arrogance, and tripped over its own feet in developing new products. Its share of the mobile-phone market has crumbled from 26% in 1996 to 14%, according to financial researcher Wit Soundview Group. Nokia, on the other hand, has boosted its share to 36% from 20%. "Motorola dominated the communications market and had every right to be the leader going forward," says Richard H. Earnest, a portfolio manager at HighMark Capital Management Inc., which has sold most of its holdings in Motorola and now has about 250,000 shares. "This company has made a lot of mistakes."

Now, Christopher B. Galvin, Motorola's chief executive, is making it his personal mission to resurrect the company's wireless-phone business. In a rare series of interviews with *BusinessWeek*, Galvin laid out a far-reaching plan for turning around the troubled division. He is insisting that the struggling unit report directly to him, instead of to another top executive. He is meeting with the division's brass to plot strategy once a week, instead of once a month as in the past. He is cutting costs to boost gross margins to 27% in 2002, up from 20% last year—putting Motorola closer to Nokia's 32% margins. And

he is pushing for faster development of more innovative products. By August, for example, Motorola will bring out a sleek clamshell phone with Caller ID for business execs and an inexpensive phone with candy-colored face plates and FM radio for teenagers. "We think these are really neat phones," declares Galvin.

FIRING FRIENDS. The most radical change is Galvin's willingness to fire top execs, who used to have something approaching lifetime tenure at the company founded by his grandfather. Last October, he pushed out Merle L. Gilmore, a Motorola veteran and a personal friend who oversaw the mobile-phone business and other wireless operations. Over the past year, 11 out of the 19 managers in the wireless group have been replaced. And not one of the 19 managers has reached the three-year mark at the wireless-phone maker. Mike S. Zafirovski, a well-respected exec who spent 24 years at General Electric Co. and ultimately ran its lighting business, was hired as the president of the wireless-phone division last year. "That's how you get things to change," says Galvin. "You get a great new team."

Will Galvin's efforts be enough to turn around the wireless-phone unit? Although he should be able to return the division to profitability, he's unlikely to restore Motorola to its former glory as the market leader in mobile phones. The planned cost-cutting and the hiring of Zafirovski are solid, incremental steps. But the latest moves are unlikely to make Motorola innovative enough to regain market share from Nokia in the near-term.

The company has had a tin ear for hearing what customers want in recent years. In 1997, it spent most of its money developing analog phones, while wireless companies were buying digital phones. Then it missed the mobile phone's evolution to a mass-market product: It focused on selling mobile phones that cost \$200 or more until last year, even though consumers typically wanted to spend less than \$100. Last spring, SBC Communications Inc. had to pull ads featuring one of Motorola's inexpensive phones because the company didn't deliver them on time. "Our demand for Motorola phones was soured because they were late getting the phones to market," says Frank C. Boyer, a vice president at Cingular Wireless, the recently formed joint venture between SBC and BellSouth Corp.

Galvin concedes that the company has missed market shifts in the past, but he says it's more sensitive to customers now. For example, he's visiting or talking to customers several times a week and formed a new group to cater to the needs of large, global customers. "We recognized our problem and fixed it," he says.

Still, this is the third major overhaul the wireless business since Galvin took over as CEO in 1997, and skeptics say there's little reason to believe this one will be much more successful than the previous two. "Motorola has technical prowess, but it is hopeless in addressing consumer needs," says Choi Dong Jun, marketing director for Korea's Apple Telecom, which makes mobile phones for the company and is 51%-owned by Motorola. "It has grown into a big dinosaur."

Besides the problems in the mobile phone business, the \$38 billion Motor-

GALVIN'S FIX-IT PLAN

Once the No. 1 of wireless phones, Motorola's worldwide market share has slipped from 26% in 1996 to 14%. Now, CEO Galvin is trying to fix the strategy for the business.

TIMEPORT
WRONG NUMBERS
Motorola just logged its first quarterly loss in 15 years. Its stock has fallen from 60 to about 15 in little over a year

has been squeezed by slowing demand in its semiconductor business, cutbacks by telecom companies that buy its wireless equipment, and the general economic malaise. The latest blow: On Apr. 10, the company reported its first quarterly loss in 15 years. Its stock has collapsed from \$60 last March to about 15.

Reviving the mobile-phone business is key to Galvin getting Motorola back on track. It's the company's largest division, with \$13 billion in sales. Moreover, it generates billions in revenues for other divisions. Motorola's mobile phones, for example, use chips from its semiconductor business. In the disastrous first quarter, the mobile-phone business led the fall: The division's sales sank 29% for the period, to \$2.3 billion, while it lost \$402 million on operations, compared with an operating profit of \$53 million in the first quarter of 2000.

KISS OF DEATH. The latest gaffe is spiraling expenses. Last year, gross margins shrank to 20% at the same time administrative and marketing costs climbed to 20% of sales. Bottom line: Motorola wasn't making a dime in its most important business. "That's the kiss of death," admits Zafirovski. Costs rose because of a "skunk works" approach, in which as many as 15 teams of 20 people developed different phones. The teams often

reach Galvin's goal and he'll still have twice as many phone types as Nokia.

Galvin and Zafirovski are taking other radical steps. In the past, the wireless business often used chips and batteries made by Motorola's other units, even though the process slowed handset development. Zafirovski has unshackled his group. For example, he buys chips from Qualcomm Inc., even though Qualcomm has been a bitter rival in the past. "If you're not the best supplier in the world, we're not going to use you," says Zafirovski.

Galvin insists Motorola's troubles aren't dire. He points out that the company's broadband division, which makes cable modems, is performing well, and so is the unit that makes global-positioning systems for cars. Although he acknowledges that his previous restructurings haven't worked perfectly, he attributes most of the company's financial woes to the sluggish economy. "No one was predicting [the economic recession]," explains Galvin.

These days, Galvin can be found

**CHRIS GALVIN,
CEO OF
MOTOROLA**

ON Galvin has been more involved in the division. He has top management a week, and he is often in the past. He is the unit's reporting to him, and of to another division.

NEW BLOOD The executives responsible for Motorola's lost market share have been canned. In the past year, 11 of the top 19 managers in the mobile-phone division have been replaced, and Galvin has hired Mike S. Zafirovski, a respected GE veteran, to lead the group.

SPEED UP INNOVATION Motorola has alienated customers, including SBC Communications, by missing deadlines for new products. Galvin aims to cut product development time from 18 months to between six and nine months.

CUT COSTS Galvin's goal is to slash sales, marketing, and administrative expenses to \$1.6 billion this year, down from \$2.4 billion in 2000. That should help the division return to profitability by the fourth quarter.

used different parts, making manufacturing and purchasing an expensive headache. Last year, Motorola had 128 different phone types and used a staggering 550 different silicon pieces on the circuit boards inside the handsets.

To lower costs, Galvin is simplifying product development. His target: to reduce the number of phone types by 84%, to 20, and the number of silicon components by 82%, to 100—all by 2003. "Now we have a systematic product plan that uses common parts," Galvin says. Still, it may not be enough in the treacherous chip markets. It will take two years to

every Tuesday at the headquarters of the mobile-phone division in Libertyville, Ill. On one wall of a conference room is a full lineup of phones from each major rival. Nearby are the phones that Motorola plans to introduce over the next three years. Sizing up the competition, Galvin likes his chances. "We have wonderful opportunities ahead of us," he says. When the economy rebounds, "Motorola plans to be ready." Is he right this time? The future of his grandfather's company may depend on it.

*By Roger O. Crockett in
Libertyville, Ill.*



PHOTOGRAPH BY MICHAEL L. ABRAMSON

COMMENTARY

By John Carey

COSTLY DRUGS: AN EVEN BLOODIER BACKLASH AHEAD

For drugmakers, these should be the best of times. Their recent profits have been up in the stratosphere, and their labs are churning out stunning breakthroughs. At a mid-May meeting of oncologists in San Francisco, for example, researchers trumpeted a slew of experimental drugs that promise major progress in the war on cancer.

Yet drug companies top the enemies' list of everyone from insurers to state legislators. The reason: soaring drug costs. Spending for outpatient prescription drugs jumped 18.8% last year, to \$131.9 billion, says the National Institute for Health Care Management—and the trend will only get worse.

Already, mounting drug bills are helping to push state Medicaid programs over budget, causing HMOs to cut services or boost premiums, and forcing some seniors to choose between drugs and food. "The problem is huge," says Representative Thomas H. Allen (D-Me.).

COLLISION COURSE. The rising bills have also created a powerful backlash, putting the twin titans of health care—insurers and drugmakers—on a collision course. The latest clash occurred on May 11 when California insurer WellPoint Health Networks Inc. argued before a Food & Drug Administration advisory committee that Claritin and two other popular allergy drugs should be sold over the counter, not by prescription only. That would slash prices to consumers—and also save insurers hundreds of millions of dollars because they would no longer

foot the bill. Now the decision moves to the FDA, and possibly the courts.

That's just one battle in a major assault on drug costs. Maine has passed a price-control bill. Vermont got a waiver to extend mandatory Medicaid discounts on drugs to seniors who don't qualify for Medicaid.



ications. A government-sponsored panel's recommendation that more Americans take cholesterol-lowering medicines will boost the already-soaring sales of drugs like Pfizer's Lipitor, worth \$3.7 billion in 2000. New cancer treatments spotlighted at the annual meeting of the American Society of Clinical Oncology (page 87) will push costs even higher. Products like Novartis' Gleevec offer hope that patients could keep cancer at bay over the long haul. But Gleevec, which won FDA approval on May 10, will cost up to \$2,400 a month, and patients may have to take it for years.

The risk is that people will be denied access to lifesaving drugs simply because they—or their insur-

What good is a new pill that cures cancer if no one can afford it?

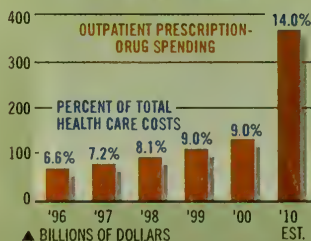
ers—cannot afford them. Few health-care experts believe it will come to that. After all, providers already pony up for AIDS drugs that cost \$12,000 a year, or for biotech drugs that run as high as \$300,000 a year. And clearly, some new drugs could lower overall costs by slashing hospital and surgical bills.

Still, health care is inevitably headed for a crisis. "I believe new technology, including drugs, will become so expensive in the next 10 years that it will break the health-care bank," says Dr. Alan L. Hillman, professor of medicine and business at the University of Pennsylvania's Wharton School. Either the U.S. will have to spend a far bigger chunk of GDP on health care or begin the agonizing process of explicitly rationing care. Today's fights are early battles in a much larger war ahead.

Other states are setting up "buyers' clubs" to get enough clout to force drugmakers to lower prices. Meanwhile, government regulators have subpoenaed records from scores of companies to probe whether drugmakers have illegally kept generic drugs off the market. And in Washington, lawmakers have introduced bills to require discounts for seniors or to eliminate the legal loopholes used by pharmaceutical companies to block generic copies. "I see a long-term threat beginning to build," says Paul Heldman, health analyst for Schwab Capital Markets. "The drug industry can only stop things for so long."

Clashes over who gets access to costly drugs and who picks up the tab are bound to intensify as more people turn to expensive new med-

THE RISING DRUG BILL



▲ BILLIONS OF DOLLARS
Data: HCFA, National Institute for Health Care Management

Carey covers medicine from Washington.

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FINANCING

WHERE CAPITAL IS STILL VENTURING

As valuations return to earth, startups get another look

Mazin Ramadan considers himself lucky. Despite the seeming meltdown in venture capital spending, his startup, Seattle-based 4thpass Inc., announced on May 7 that it had snagged \$8 million in seed capital. Ramadan attributes his good fortune to a solid business plan, a seasoned management team, and promising technology. "There is money," says Ramadan. "But you have to have a really good story, have done your homework, and be ready with customers. Venture capitalists aren't just going to buy anything."

The amazing thing is that they're still buying at all. Total VC investing sank 43%, from \$20.5 billion in the fourth quarter of 2000, to \$11.7 billion in the first quarter of 2001, according to researcher Venture Economics. But when VCs do buy, it looks increasingly like startups are where they want to put their money. Although the percentage of early-stage financings remained steady at 14% over the previous two quarters, 21% of all venture dollars have gone into startups so far this quarter.

"GOOD DEALS." What gives? Experts say the relative strength of the startup marketplace stems, at least in part, from the continuing quest for the next great idea. But even more important, they say, it's a

reflection of a healthier business environment for new enterprises that don't come with the baggage from the recent tech frenzy. For instance, dot-com bankruptcies and layoffs at tech giants have suddenly made recruiting talented execs and employees a breeze. Obtaining office space, as well as professional services from headhunters and lawyers, has gone from being a costly ordeal to a simple task.

And the sky-high valuations of unproven fledglings, which landed many VCs in hot water last year, are a thing of the past. The average price for startup deals fell from \$20 million in the last quarter of 2000 to \$14 million in the first quarter of 2001, according to Venture Economics. "Overall, the cost of doing business is much, much less than it was a year ago," says Tracy T. Lefteroff, managing partner of private equity and venture capital at PricewaterhouseCoopers. "It leads venture capitalists to be very active in looking for good deals."

Those so-called good deals are showing

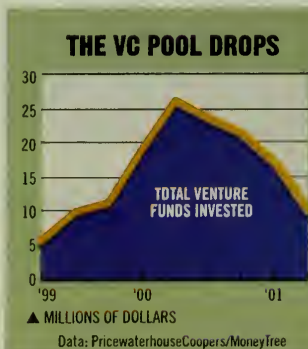
up in some unexpected places. Surprisingly, many investors are as enamored of the Net as ever. Of the 21 seed financings in the most recent quarter, 148 are Net-related, says a PricewaterhouseCoopers/MoneyTree survey. The vast majority of those companies, some 136, are being built around the hardware and software tools needed to help consumers and businesses make better use of the Internet. For instance, Ecount.com, a next-generation online payment system, landed \$11 million earlier this year. B3, a business-to-business software maker, nabbed \$1 million, and Peribit Networks Inc., which is developing technology to improve network performance, got its first funding in January.

Despite all the financial woes and turmoil in the telecom sector, investors are also lining up to place bets on wireless startups. Wireless, in fact, is one of the few sectors, along with biopharmaceuticals and medical devices and equipment, in which the net dollars flowing into startup deals are going up. Total spending on wireless equipment and services venture rose from \$59.5 million in the last quarter of 2000 to \$93 million in the first quarter of this year, says PricewaterhouseCoopers. "Everyone is looking for the killer application in the wireless space," says Jesse Reyes of Venture Economics.

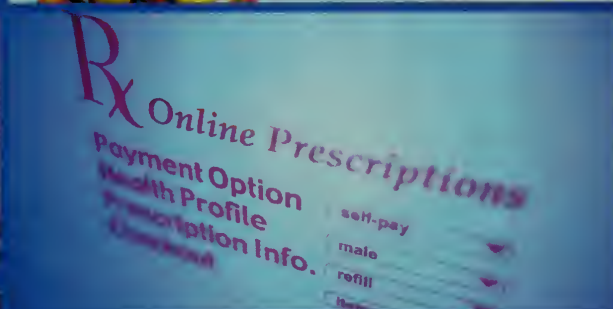
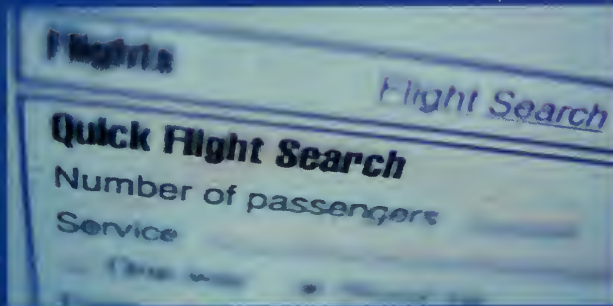
It's all pretty optimistic, considering the countless millions already lost in wireless investments and technologies. Now investors once again are willing to pour—and quite possibly lose—many millions into more risky deals. Still Geoffrey Y. Yang, a partner at Redpoint Ventures, says the time is right to bet on wireless because mobile technologies and devices are improving, and networks handling data are becoming standardized. That's why his firm and Accel Partners in January funded \$38 million in Tahoe Networks, which develops tools to speed delivery of data to mobile devices.

No one, of course, expects funding to return to its record pace of the last three years. Indeed, experts say venture funding overall will continue to be sluggish. But as long as some investors are willing to roll the dice on a few good ideas and businesses, venture-capital money ought to keep right on flowing.

By Linda Himmelstein in San Mateo, Ca



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DEALS

LEAVING WALL STREET—AND GOING PRIVATE

Battered tech companies are making the change

For someone who has had a hand in hundreds of high-tech initial public offerings since 1969, Sandy Robertson has been making a surprising pitch to tech companies in the past year: Let me take you private. True, many boards aren't yet ready for the overtures of the former Silicon Valley investment banker. "I'll offer \$6 for a stock that has fallen from \$30 to \$4—but the board is convinced it's going back to \$20," says Robertson, who now runs Francisco Partners, one of a handful of private equity funds focused on taking tech companies private. "But once that price has stayed at \$4 for a year, we'll see those guys again."

That day may come sooner rather than later. With technology reporting some of the worst earnings on Wall Street and with once-acquisitive companies in retreat, weak stock prices have left many companies suddenly considering the option of taking all or part of themselves private again. Conglomerates such as Hyundai, Motorola, and Xerox are in talks to turn slow-growing or money-losing divisions into private companies of their own. Even mature companies in out-of-favor markets, such as Novell and 3Com, are considered candidates to go private. "There are many companies trading at a discount to what they would be worth if they were private," says venture capitalist David F. Marquardt of August Capital.

Indeed, as valuations plummet, many more are looking to take advantage of

such gaps. In 2000, 17 tech outfits worth \$13.6 billion went private, including drive-maker Seagate Technologies. That's up from four deals worth \$1.6 billion in 1998. And this year, things have intensified. On May 14, Seneca Investments announced it was making a bid to take Agency.com, a Net consulting firm, private. Earlier this month Los Angeles takeover firm Gores Technology Group bought the Verifone division of Hewlett-Packard, a \$350 million unit that makes credit-card readers, as well as Micron Electronics' \$1 billion PC division.

So whose divisions are said to be in play? Hyundai's semiconductor memory business; Lucent Technologies' optical fiber division; Xerox Corp.'s Palo Alto Research Center, and its share in a year-old venture to build ink-jet printers with Sharp and Fuji Photo Film Co.; and Motorola's Integrated Information Systems Group, which makes communications systems.

The reasons are many. After years of spending freely to chase Net ventures, many CEOs have crimped budgets. Now, they're focusing on the core, strategic businesses that pay the bills. Indeed, shedding slower-growing or

money-losing businesses will lift quarterly earnings. "One way to make good on that 15% growth target is to sell the divisions that are growing 5% and 10%," says Jim Coulter, a partner at Texas Pacific Group, which has been taking firms private since 1993.

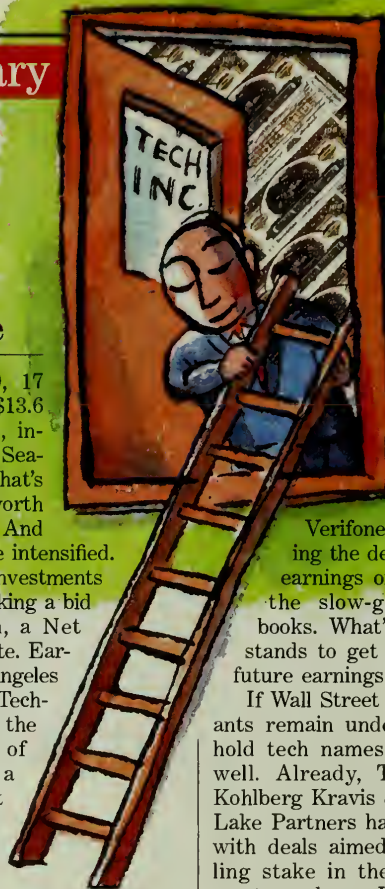
Consider HP's decision to sell its Verifone division. By completing the deal before it announces earnings on May 16, HP clears the slow-growing unit off its books. What's more, the company stands to get an undisclosed cut of future earnings from Gores.

If Wall Street valuations for tech giants remain underwater, some household tech names could go private as well. Already, Texas Pacific Group, Kohlberg Kravis & Roberts, and Silver Lake Partners have approached Xerox with deals aimed at taking a controlling stake in the company, but talk went nowhere. Industry insiders say dealmakers have also been sniffing around 3Com, Novell, and, most notably, Apple Computer.

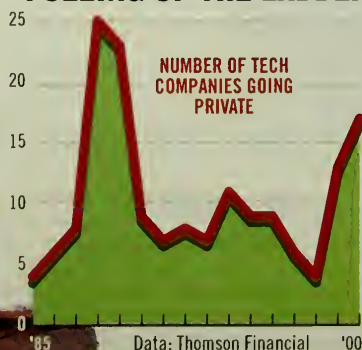
REVOLTS. Of course, going private isn't for everyone. Nobody wants companies with no cash flow or products in danger of becoming obsolete. What's more, companies risk shareholder revolts if they accept low-ball bids. Says shareholder rights expert Nel Minow: "We don't want to see any fire sales—but it may be that going private is the best way for shareholders to get some value [from their tech holdings] these days."

Still, going private has plenty of advantages, say executives who have tried it. Since Seagate went private last November, CEO Stephen J. Luczo no longer has to devote 35% of his time to wooing Wall Street. "I'm doing the things a CEO should be doing," he says. Now, Luczo focuses on operations and morale and is free to make long-term investments that would have previously trashed the stock. He's now investing heavily in move into more lucrative storage-equipment businesses, for example, rather than just selling commodity disk-drives. "It's like we pulled into a safe port, just as all those other ships were heading into stormy seas," says Luczo. Many others may find such protection attractive in the coming months.

By Peter Burrows in Silicon Valley



PULLING UP THE LADDER



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SPORTS BUSINESS



BRING A BLANKET: In Dayton seating along the right-field line is on the grass

FOR THE LOVE OF THE GAME—AND CHEAP SEATS

Families—and investors—are flocking to minor-league teams

It has been a long, long time since something this good has happened in Brooklyn. Professional baseball is finally coming back 44 years after the beloved Brooklyn Dodgers decamped for Los Angeles. So what if the Brooklyn Cyclones aren't even close to major league status? Their spanking new ballpark is rising alongside the boardwalk in Coney Island, once America's premier amusement park but for decades a seedy ghost of its former self. The big day is June 25, when KeySpan Park, a \$39 million, 6,500-seat gem, opens to a sell-out crowd. And if the action drags a bit, fans can take in views of the shimmering Atlantic Ocean, the famed parachute drop, and the Cyclone roller coaster just over the left-field wall.

Like the minor-league baseball renaissance all across the country, the idea behind the Cyclones, a New York

Mets farm club, isn't as much about baseball as it is about marketing good old-fashioned summer entertainment at a great price: The most expensive ticket is \$10. Every Friday night game will feature fireworks, and Sundays will be Kids Club Day, when, after the game, thousands of children will pour

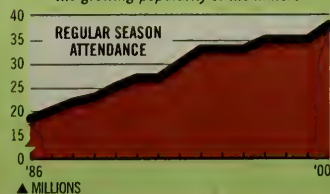
onto the infield to run the bases. And check out Russian Night, Irish Night, Italian Night, Jewish Night, an African-American Night. "We're going to have something fun going on every inning," says Jeffrey S. Wilpon, a Cyclones owner and a former minor-league player himself.

Increasingly, it's the kind of fun the big-time Hollywood types and other prominent businessmen—not to mention a virtual Who's Who of former ball players, big-name broadcasters, and other celebrities of various stripes—are working to turn into money-making, easing concerns. With minor-league booming from Rancho Cucamonga, Calif., to Portland, Me., an eclectic bunch of owners from Hall of Famer Nolan Ryan to a pair of Buffetts—investor Warren and singer Jimmy—are getting in on the act.

HAMMING IT UP. And what an act. The St. Paul Saints, owned, in part, by actor Bill Murray—self-described as the "president and director of fun"—has trained pigs wearing shades delivering free balls to umpires. At Dell Diamond in Round Rock, Tex., where Ryan's E-

GOING, GOING, GONE

There's nothing bush league about the growing popularity of the minors



Data: National Association of Professional Baseball Leagues Inc.



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press plays, fans can pay to swim in a pool to cool off while watching the game. "This is all about generating excitement so that people will come out of their houses," says former Sony Pictures Chairman Peter Guber, whose company Mandalay Sports Entertainment owns the Dayton Dragons and three other minor-league teams. After every Dayton homer, a dragon looming over the outfield spews flames through its mouth. "I could put up a movie theater in Dayton, but there would be 15 others just like it. I'm the only baseball team in town."

Such titans of the minors as Guber are getting a big boost from municipalities that are hurling money at builders to put up parks quicker than a Nolan Ryan fastball. New York City is spending about \$120 million on minor-league parks, including a \$70 million complex for the Staten Island Yankees. In Toledo, the county, together with the state government, is funding a \$39 million stadium or the Mud Hens, a Detroit Tigers feeder. The rickety leachers that once typified minor-league ball have been replaced by luxury boxes, "party decks," and even conference centers. Since 1990, 74 of the 60 teams affiliated with clubs in the majors have gotten new stadiums, with six more under construction. In some cities, teams help pay for ballparks. In most, however, including New York, taxpayers foot the bill and teams pay rent.

CORPORATE LINKS. The minors have also succeeded in pitching their squeaky-clean image to big corporations willing to spend additional millions for ballpark naming rights. In Jackson, Tenn., the West Tenn Diamond Jaxx play in Pringles park, named after the potato chip maker. In Round Rock, Dell Computer Corp. paid \$2.5 million in a 15-year-deal to call the Express park Dell Diamond. That's money well spent: The Express, which draws big crowds from Austin's suburbs, last year set a AA attendance record with 660,100 tickets sold. Round Rock is hardly the only place where attendance is surging. Fans paid an average \$8 per ticket to boost attendance last year, to 37.6 million. That's double the number who took in a minor-league game back in 1985 and just shy of the record set in 1949. For around \$45, a family of four can

CONEY ISLAND: Opening day, June 25, is already sold out

buy tickets, drinks, hot dogs, and programs. And for that price, fans are right on top of the action—easily within earshot when the ump and players start hurling choice insults at each other. Compare that with the big leagues, where an average ticket price is \$19 and a day at the park will run a family of four about \$120. "A minor-league game is just a more pastoral experience," says Robert A. Baade, a Lake Forest College economics professor who specializes in sports business. "The games also have that enduring *Bull Durham* kind of thing where everybody is playing their hearts out to make it to the big leagues."

Play Ball!

High-profile business types and celebrities take a swing at the minor leagues



LOCATION
Round Rock, Tex.
AFFILIATION
Houston Astros
CO-OWNER
Nolan Ryan



LOCATION
Omaha
AFFILIATION
Kansas City Royals
CO-OWNER Warren Buffett



LOCATION
Southwest Florida
AFFILIATION
Minnesota Twins
CO-OWNERS
Actor Bill Murray, singer Jimmy Buffett



LOCATION
Portland, Me.
AFFILIATION
Florida Marlins
CO-OWNER Former Capital Cities/ABC CEO Dan Burke



LOCATION
Jackson, Tenn.
AFFILIATION
Chicago Cubs
CO-OWNERS TV announcers Bob Costas and Tim McCarver, director Ron Howard, talk show host Maury Povich



LOCATION
Dayton
AFFILIATION
Cincinnati Reds
CO-OWNERS Producer Peter Guber, Magic Johnson



In smaller cities, where the entertainment choices are few and far between, a popular minor-league team can become an integral part of a community's identity. In 1995, for instance, the city of Harrisburg, Pa., bought the AA Senators franchise for \$6.7 million to ensure it didn't move to Springfield, Mass. The team has been profitable every year since, according to team officials, posting net profits of about \$400,000 last year. Just as key, it has kept the folks of Harrisburg happy.

"JUST GREAT." The truth is, anybody with a few million dollars to spare can get into the business. The cost of entry is relatively low—about

\$15 million tops to own your own AAA team, the last stop before heading to the bigs. Major league teams pay the salaries and uniforms of the players on their affiliate teams. The local owners, though, collect revenues from tickets, concessions, and parking where it's not free. With the new stadiums and a growing competitiveness between cities and towns to lure teams, franchise values have shot up. A Class AA team that might have been worth \$3 million 10 years ago goes for \$7 million to \$9 million today, some minor-league owners say.

But such mundane concerns as money aren't on the minds of most folks strolling along the Coney Island boardwalk during one sunny spring day recently. As construction workers put the finishing touches on the stadium, Tom Pedi, a 60-year-old retired security guard, gawks at the new ballpark in amazement. He remembers the Dodgers' fate all too well. "It's just great to have the game back here," says Pedi. "This will do a lot to heal the wounds." It has been a long wait, so let the fireworks, the parties, and the kids running everywhere begin. And, oh yeah. Let's play ball, too.

By Tom Lowry in Brooklyn and Ronald Grover in Los Angeles, with Lori Hawkins in Austin and David Polek in New York

In Business This Week

EDITED BY MONICA ROMAN

THE TIDE TURNS FOR BIG TOBACCO

BIG TOBACCO MAY HAVE HAD to swallow a \$368 billion settlement with the states and may still be facing a federal suit. But cases brought by individual smokers continue to be snuffed out. The latest defeat: a ruling by a New Jersey jury that Philip Morris and R.J. Reynolds Tobacco aren't responsible for the death of a woman who quit smoking 20 years before she died in 1997. The verdict shows how hostile juries have become to arguments that tobacco companies purposefully mislead smokers. In this case, the jury accepted the reasoning that the woman made an informed decision to smoke—even though she took up the practice in 1951, years before the hazards of smoking were fully documented. Tobacco

companies have now won 16 of the last 17 such cases.

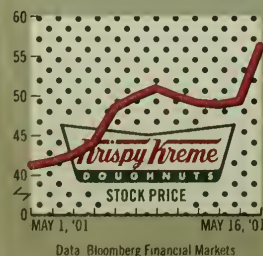
PLAYSTATION 2 GETS WIRED

IT MAY LACK THE GORINESS of the computer game *Soldier of Fortune*, but Sony is clearly gunning for Microsoft's soon-to-be-introduced Xbox video game player. Sony signed deals with AOL Time Warner and RealNetworks to further plans to link its popular PlayStation 2 video player to the Internet. Sony can now market its player to AOL's 29 million subscribers and will offer such AOL services as instant messaging and e-mail. Sony's PlayStation 2 will also include RealNetworks' popular RealPlayer software, letting users download videos for games and other uses. The Sony moves come as Microsoft prepares a \$500 million marketing blitz to introduce its Xbox player on Nov. 8.

CLOSING BELL

SUGAR HIGH

Looking for shelter from the tech storm? Think doughnuts. Krispy Kreme Doughnut shares surged 14.2%, to \$56.40, on May 16 after the Winston-Salem (N.C.) company reported a sweet 89% jump in first-quarter profits, to \$5.7 million. Revenues rose 24%, to \$87.9 million. And while other companies are lowering earnings expectations, Krispy Kreme confidently boosted its estimates through 2002.



BLACK INK ALL OVER HEWLETT-PACKARD

FOR YEARS, HEWLETT-PACKARD execs have fumed when rivals dismissed HP as "that printer company." But judging from its May 16 earnings report, HP may well be "the printer ink company." While profits from the printer supplies business aren't disclosed, analyst Toni Sacconaghi of Sanford C. Bernstein estimates the unit delivered \$500 million in operating profit on sales of \$2.4 billion in the quarter. The rest of HP's businesses—printers, PCs, and other tech gear—actually lost \$100 million on revenues of \$9.2 billion, he says. But there's a silver lining: With little competition, 50%-plus margins, and 200 million customers buying cartridges every few months, HP's ink business may be the most lucrative in all of tech.

HEADLINER: ALBERT DUNLAP

THE CHAINSAW AL MASSACRE

THERE'S ONE THING THAT the Securities & Exchange Commission and lawyers for Albert Dunlap can agree on: The SEC sees "Chainsaw Al" as the poster boy for financial fraud.

On May 15, the SEC sued Dunlap, former CEO of now bankrupt Sunbeam, and four other former company executives, charging that they falsely pumped up Sunbeam's 1996-98 earnings to boost the value of their Sunbeam holdings.

Dunlap—who earned his nickname by ordering huge layoffs when he was restructuring Scott Paper—calls the SEC accusations

"totally false." His attorneys charge that the SEC is using Dunlap as "a high profile and easy target" in its crackdown on bad accounting.

But Dunlap isn't likely to be alone in the dock for long. The SEC is investigating dozens of audit failures, with more cases likely within weeks. Accounting firm Andersen wasn't charged for its audits of Sunbeam, but it could be cited for overlooking inflated profits at Waste Management. Andersen won't comment on SEC matters.

By Mike McNamee and Christopher H. Schmitt



SUNTRUST TAKES A RUN AT WACHOVIA

HOSTILE TAKEOVERS HAVE long been considered taboo in banking circles—and particularly so within the clubby world of Southern banks. But the rules of engagement have changed: On May 14, Atlanta-based SunTrust Banks launched a rare \$13.6 billion hostile bid for Wachovia, a Winston-Salem (N.C.) institution that had agreed in April to be acquired by First Union for \$12.7 billion. First Union and Wachovia executives maintain that SunTrust's hostile bid won't alter their existing pact. But analysts believe that First Union will have to sweeten its offer.

CHICAGO'S BOARDS TEAM UP, FOR ONCE

AFTER LOSING THE LEAD ON futures on individual stocks to the London International

Financial Futures & Options Exchange, Chicago's markets are determined to catch up. The Chicago Mercantile Exchange, the Chicago Board Options Exchange, and the Chicago Board of Trade (CBOT) on May 14 agreed to set up an electronic exchange to market the futures what they become legal in the U.S. The CBOT is a junior partner in the venture, with just a 10% stake, while the other two exchanges each own 45%. Institutions will be able to trade the products Aug. 21 and individuals on Dec. 3.

ET CETERA...

- Drugstore chain Rite Aid expects to obtain \$3 billion in financing and credit by August.
- Delta Air Lines' regional Comair laid off 2,400 workers because of its pilots' strike.
- Fidelity Investments canceled merit raises for employees earning over \$75,000.

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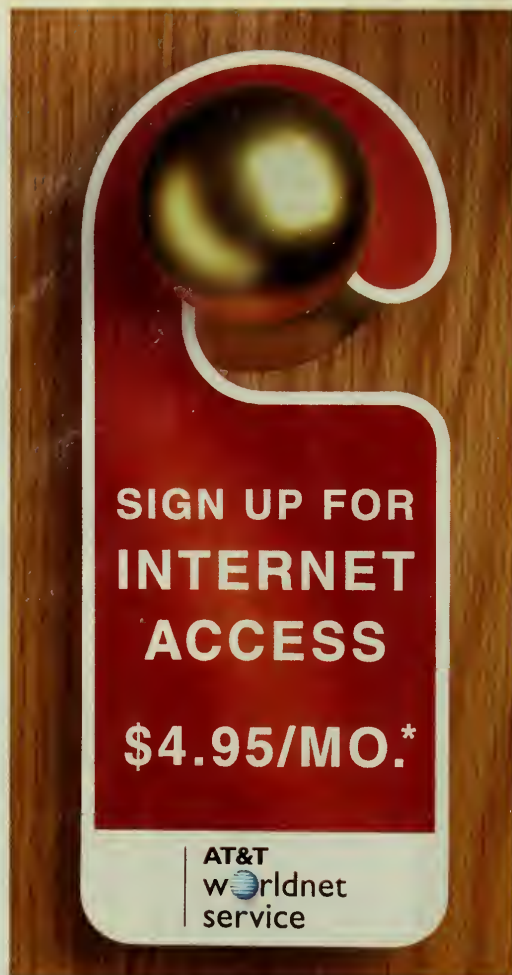
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EDITED BY PAULA DWYER

WHY BUSH WILL KEEP GETTING DEMOCRATS TO JUMP SHIP

For 23 years, Montana Senator Max S. Baucus has cultivated an image as a low-profile, behind-the-scenes lawmaker who zealously guards the interests of his state's farmers and ranchers. His record as a fiscal moderate and free trader has won him friends in the business community, just as his support for spending on social programs has won him plaudits from the Left. But when it matters most, the top Democrat on the powerful Senate Finance Committee has generally been true-blue to his party.

Not anymore. Baucus, 59, irritated the Democratic leadership when he worked hand-glove with Finance Committee Chairman Charles E. Grassley (R-Iowa) to produce a plan to cut taxes by \$1.35 trillion over 11 years while dropping the 39.6% top marginal rate to 36%, up from President Bush's proposed 33%. The deal would focus most of this year's short-term relief on the middle class and give the wealthiest 1% slightly less cash down the road than Bush's initial plan. The compromise survived a series of Democratic assaults in committee on May 15. If it holds together on the senate floor, Baucus could prove to be a big-time player on the biggest issue in town.

TARGETS. A frustrated Senate Minority Leader Thomas A. Daschle (D-S.D.) called the agreement "difficult to accept, impossible to explain." But the White House cheered—for more reasons than one. Bush sees Democratic Senators up for reelection in 2002, or whose states supported him last year, as possible crossover votes on key issues. Next, Bush will try to peel off Louisiana's Mary L. Landrieu, whose term expires in 2002, on energy legislation. Likewise, New Jersey's Robert G. Torricelli and Georgia's Max Cleland, both of whom face voters next year, are in Bush's sights. Another target: Ben Nelson of Nebraska, a state Bush carried handily.

Revolts such as Baucus' undercut Democratic leaders at a

time when they're trying to present a united front against the GOP. By working with Grassley, Baucus deprives Democrats of their favorite argument against the tax cut: that it was rammed through by Republicans to benefit their rich donors.

So what made Max do it? As a Democrat in a conservative and increasingly Republican state, he is one of the GOP's top targets in the 2002 election. By embracing a big tax cut, Baucus carves out a position that's independent of his leadership and more moderate than the national Democratic Party.

"There's no question what's motivating Max Baucus: November, 2002," says Stephen Moore, president of the Club for Growth, a supply-side lobby group. "Montana is a very conservative, pro-tax-cut state. This is the kind of deal that can save Baucus' seat."

FARM TEAM. Baucus has been working with Grassley ever since the 2000 election elevated them to the top of the influential tax-writing committee. Baucus says he called his Iowa colleague right after the election and offered to work with him on a tax bill. "One is much more likely to get something accomplished by being at the table than not," says Baucus.

Each week, Grassley and Baucus take time to talk policy and politics, alternating their visits between offices. They share passions ranging from pension reform to agriculture: Grassley is an Iowa pig farmer, and Baucus is from

an old Montana ranching family. The two are likely to team up on the next big issue facing their panel: Bush's request for broad authority to negotiate trade deals.

Given Baucus' dicey political outlook in Montana, most Democrats seem willing to forgive him. True, they may grumble for a while. But with the Senate split 50-50, every vote counts. And if the time ever comes that Daschle gets a shot at Senate Majority Leader, he knows Baucus will do the right thing.

By Richard S. Dunham



BAUCUS: Looking to 2002

CAPITAL WRAPUP

FROM TAXES TO DRUGS

► Even as his panel completes work on a massive \$1.35 trillion tax cut, Senate Finance Committee Chairman Charles E. Grassley (R-Iowa) is looking ahead to a prescription-drug plan for seniors. Grassley is already working to pull together a deal on the contentious issue and says he hopes to have a compromise plan ready for committee action by August. The big sticking point: Republicans want Medicare reform as part of the package, while most Dems just want the drug benefit.

SEC SPOTLIGHT

► The Securities & Exchange Commission plans to step up scrutiny of foreign companies doing business in Cuba, Sudan, and other countries subject to U.S. sanctions. Responding to Representative Frank R. Wolf (R-Va.), the agency said it will review offerings of shares in the U.S. to ensure that these companies are fully disclosing their business practices and political risks. Wolf says investors should know if a foreign company has aided or abetted terrorism, slavery, or religious persecution.

WARMING TO CO₂?

► President Bush may have backed away from a campaign promise to curb CO₂ to combat global warming, but Administration officials are quietly considering a proposal from five major utilities to include CO₂ in a comprehensive approach to tackling pollution. Utilities such as Wisconsin Electric Power figure limits are inevitable and want to design a flexible, reasonable strategy now. "We're working to convince them that it's O.K. to do something on CO₂," says a utility lobbyist.

DIPLOMACY

ASIA

THE NEW U.S. STRATEGY

In Tokyo, there is lofty talk of Japan enhancing its role as linchpin for America's security presence in Asia. In New Delhi, there is murmuring in political circles over the Defense Ministry's warm reception of President George W. Bush's grandiose plan for a missile defense system. In Taipei, the government of President Chen Shui-bian is cheered by one of the strongest commitments yet by Washington to defend the island against

China. And down in Singapore, the government is bragging about its huge new naval pier, which will service foreign warships such as the U.S. aircraft carrier Kitty Hawk.

None dare call it containment. But to leaders in Beijing—and defense analysts around the Pacific Rim—it sure seems America is trying to coordinate a regionwide effort to check China's growing military might. That's the diplomat-

ic buzz in the wake of mid-May visits by Deputy Secretary of State Richard L. Armitage to Tokyo, Seoul, and New Delhi. At the same time, Paul D. Wolfowitz, the hawkish Deputy Defense Secretary, made a swing through Europe that included a visit to Russia, the other major power on China's border.

The Chinese, understandably, are getting nervous—and are talking about renewed arms race. Compared with the way Bush envoys were greeted elsewhere, a nine-person delegation led by Assistant Secretary of State James A. Kelly got a frosty reception at the Chinese Foreign Ministry on May 15. Kelly's explanation of the U.S. missile defense plan over tea and canned coconut drink to a Chinese team went nowhere. The U.S. plan "destroys the global strategic balance and upsets international stability," a Beijing spokesman said afterward. "China will not sit idly by and watch its national interests suffer harm."

No one argues that the Bush Administration's diplomatic blitz is the opening act of a new cold war. In its campaign to contain the Soviet Union after World War II, the U.S. worked to isolat-



INDIA'S VAJPAYEE WANTS STRONGER TIES WITH THE U.S.

INDIA

	980,000		0
	550,00		42
	140,000		1,498

CHINA

	2,000,000		27
	230,000		125
	420,000		3,632

RUSSIA

	348,000		
	171,500		
	184,600		

KIM AND JIANG: DESPITE THE NORTH-SOUTH THAW, BUSH STILL SEES NORTH KOREA AS A ROGUE STATE



REGIONAL MILITARY POWER

	ARMY		ICBMs*
	NAVY		WARSHIPS
	AIR FORCE		AIRPLANES

*INTERCONTINENTAL BALLISTIC MISSILES

NOTE: SIMPLE NUMERICAL COMPARISONS OF MILITARY STRENGTH DO NOT TAKE INTO ACCOUNT THE ADVANTAGE OF SUPERIOR WEAPONRY AND TRAINING ENJOYED BY MORE TECHNOLOGICALLY ADVANCED NATIONS

DATA: INTERNATIONAL INSTITUTE FOR STRATEGIC STUDIES, CENTER FOR DEFENSE INFORMATION, STOCKHOLM INTERNATIONAL PEACE RESEARCH INSTITUTE, JAPAN SELF-DEFENSE AGENCIES, KOREAN MINISTRY OF DEFENSE, BUSHIE.SWFEK

Bush wants to redraw the region's security map. How will Asia respond?

Moscow economically and culturally, and to thwart its adventurism with a network of military bases. In Asia, U.S. policy is to remain fully engaged with China in trade and most other matters. But clearly, what is afoot is the biggest shift in U.S. global strategy since the Reagan era. Far from being guided by right-wing isolationists, as some had imagined, President Bush is being advised by old cold warriors who believe the U.S. must act forcefully to promote its global interests and stymie China's desire to dislodge the U.S. as the dominant power in Asia. "A lot more attention," Armitage told *BusinessWeek*, "will be paid to Asia than was the case in the previous Administration."

"STRATEGIC AMBIGUITY." In essence, Washington hopes to redraw the map of Asia. At the center: America's allies, instead of China. Washington will treat Beijing as a megapower to be held in check before it becomes the dominant force in the region. Japan, which received less U.S. attention in the 1990s

as its economy swooned, is to be pushed as a bulwark in America's line of defense, an ally that must strengthen its army and be willing to fight in any conflict. On the Korean peninsula, the U.S. will again treat the communist North as a rogue state, and work more skeptically with Seoul on entente with the regime of Kim Jong Il. And India, which has long been hostile, is to be enlisted to work with the U.S. to offer a counterweight to China in the south.

It's a sharp contrast to U.S. Asian policy of the past 15 years, when the strategic focus was still on Europe and the collapsing Soviet Union. Noncommunist Asia was regarded principally as a trading and manufacturing zone, its safety largely protected by U.S. forces. China was seen as still struggling to escape the dead hand of communist economics, too inward-looking to be a real threat to its neighbors. So the policy of "strategic ambiguity" regarding whether the U.S. would intervene to defend Taiwan was maintained.

Few Americans suggested Japan get more aggressive in its military posture. And India? It was barely noticed.

But Washington is starting to see the China threat differently. A review of the balance of power in the Taiwan Strait issued last year by the Pentagon concluded Beijing's military could gain the upper hand over Taiwan by 2005. Other U.S. studies suggest China is making progress in developing more sophisticated nuclear warheads and missiles—and in turning its huge but antiquated air force and navy into a high-tech military force capable of spreading its power in the South China Sea in a few decades. "It's a classical power game," says Paul Dibb, an Australian defense analyst, of the Bush strategy. "China is emerging as the natural regional leader, and it knows it. And only one country is capable of stopping it. That's what this is all about."

With Asia



International Business

lacking anything like the North Atlantic Treaty Organization, the Bush team argues that the U.S. must maintain the peace—and thereby Asia's economic prosperity—by building up its alliances. "What we're trying to be is just a force for peace and stability in the region," says Armitage. A new study by Rand is thought to be close to the White House thinking. The study envisions a coalition of U.S. Asian allies acting jointly to quell any regional conflict. It also suggests the U.S. promote a balance of power between Russia, China, and India so that none emerges as dominant—or gangs up with others against the U.S. **HIGHER RISK?** The big question is whether these allies—whose economies are increasingly integrated with China's—will go along. Or is Washington only raising the risk of conflict by trying to create a new Asian order? The outcome is anything but assured. Few nations want to rile the region's rising giant by blatantly siding with the U.S.

That's not to say Asian leaders disagree completely with the U.S. The People's Liberation Army is indeed getting a makeover: Enriched by its booming economy, Beijing is replacing much of its rusting stockpile of 1950s- and 1960s-era hardware with Russian-made missiles, jet fighters, and warships. And PLA journals talk of a battle strategy that relies on information technology and preemptive strikes aimed at crippling a superior foe. Japanese planners worry that vital shipping lanes—its lifelines for oil and food—are at risk. The Philippines, Singapore, and Indonesia fret that China will press its claims more aggressively over the entire South China Sea. And don't forget Taiwan. "Without [China's] ongoing threats...and its missile deployment in its coastal regions," Taiwan President Chen said in a recent inter-

view, "Taiwan would not be compelled to buy weapons and defend ourselves."

The Bush strategic realignment also dovetails with new thinking in Japan and India. One priority of the new, security-minded government of Prime Minister Junichiro Koizumi is to modify Japan's postwar constitution so that it can play a more active role in regional defense. He is expected to discuss the idea further in a visit to Washington in June. "We must have the right to protect ourselves," says Tokyo Governor Shintaro Ishihara, one of China's most popular politicians. China's growing muscle "makes people worry that economic aid from Japan frees China to spend more of its own money on military hardware," adds Seiji Maehara of the oppo-

sition Democratic Party of Japan. Hence Tokyo's interest in a ship-based defense system that could knock out incoming Chinese missiles.

India wants some protection too. It has a long history of border conflict with China and believes archenemy Pakistan is turning into a Chinese client state. Although tight ties with the U.S. remain controversial, Premier Atal Vajpayee's government also hopes better ties will translate into badly needed U.S. investment. The warm reception for Armitage during his May 10-11 visit "has caused everyone to blink," says Kan Bajpai, an international relations expert at New Delhi's Jawaharlal Nehru University. Bush is expected to drop remaining U.S. sanctions imposed after

IN SINGAPORE

A new pier services warships such as the U.S.'s Kitty Hawk

New Delhi's 1998 nuclear weapon tests.

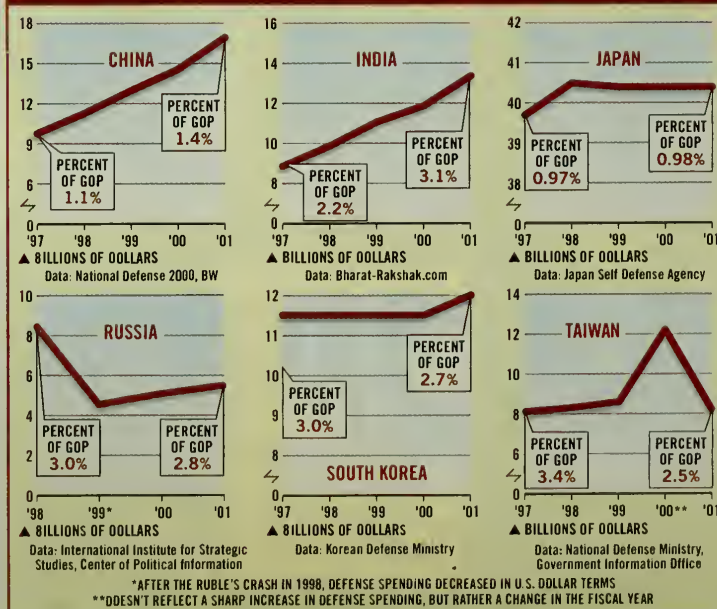
But in India the U.S. must deal with the hard truths of commerce. India's annual trade with China has grown tenfold to \$2 billion, in several years. Trade will swell further as India and China lift trade barriers to enter the World Trade Organization.

Such dual interests will keep tugging at nations across Asia. Singapore, for example, is happy to host U.S. warships but it's unlikely to join an anti-China bloc. "Singapore will not have to choose between the U.S. and China so long as there is no radical change to the geopolitical situation," says Derek Cunha of Singapore's Institute of Southeast Asian Studies.

South Korea is ambivalent. During Armitage's May 9-10 visit to Seoul, his hosts assured him America is their No. 1 ally, but did not endorse the missile shield. Seoul wants the U.S. to keep its 37,000 troops in the South, but also wants cordial re-



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"China is emerging as the natural regional leader.... And there is only one country capable of stopping it"

tions with China. Trade between the neighbors has leapt fivefold since 1992, to \$31.2 billion last year. There is even talk of small joint military exercises.

South Korea also sees Beijing playing a crucial role in its bid to normalize relations with the North. By contrast, Bush may have set years of delicate diplomacy back when, during a visit to Washington by President Kim Dae Jung, he refused to commit to continued talks aimed at getting the North to halt its nuclear program. The U.S. later reversed the position, but many Koreans doubt its enthusiasm: Pyongyang is a key justification for Bush's defense shield. Says Korean Foreign Ministry spokesman Kim Euy Taek: "The current U.S. Administration's approach [toward China] creates a more difficult atmosphere for us to advance South-North relations." During his visit, protesters pelted Armitage's car with eggs.

DEALS, DEALS. One might think the Taiwanese, at least, would embrace the new U.S. toughness wholeheartedly. But even in Taipei, many see the U.S. diplomatic offensive as a mixed blessing. They don't want to raise risks of a devastating conflict with the mainland. And there are all those business deals to pursue with China. Less than a month after the U.S. unveiled its new arms sales, former Taiwan Premier Vincent Siew visited Beijing with a group of businesspeople to promote the idea of a "common market" with China. The island's electronics manufacturers are pumping billions into the mainland for low-cost manufacturing and engineering facilities. "Taiwan is in a much tougher position than any other country in Asia," contends Andrew Yang, secretary-general of Taipei's Chinese Council of Advanced Policy Studies. "We want to encourage ties with the U.S., but our own survival is dependent on good relations with mainland China."

The new policy has gotten short shrift from Russia, too. In a May 1 speech, Bush spoke about one day cooperating with Russia to build a "joint

defense." Some in the Bush camp argue that if the U.S. lets Moscow share in some of the technological development related to missile defense, President Vladimir V. Putin might endorse the project. Such a tie-up would isolate China even more.

But Moscow has saved enormously in the past decade by reducing its troops on China's 2,500-mile frontier from 1 million to 100,000. In July, Putin and Chinese President Jiang Zemin are to meet in Moscow to sign a friendship treaty. China also is Russia's top

The Bush team hopes to convince Beijing it has nothing to fear from its moves, including missile defense. But China isn't buying it. Beijing fears the U.S. intends to neutralize its 20-some intercontinental ballistic missiles, which are capable of hitting the U.S. West Coast. In response, Beijing says its chief option would be to sharply increase production of ICBMs to overwhelm the U.S. shield. Thus, nonproliferation will go out the window. Says Yan Xuetong, a foreign policy analyst at Beijing's Tsinghua University: "I

the U.S. is the only military superpower and wants to proliferate, what [else] can China do?"

The Bush team has sketched the outlines of a new Asian policy that is as bold as it is provocative. Men like Armitage and Wolfowitz view the world through the prism of balance-of-power realism. And to their way of thinking, Asia has been too long ignored by Washington on the security front. To many Asian leaders who credit U.S. protection for the economic boom that buoyed the region in the 1970s and 1980s, the idea of strengthening the U.S. umbrella is appealing. But when they assess the ramifications



arms customer, paying it about \$2 billion annually. Indeed, China is keeping alive entire Russian factories, such as the immense Komsomolsk-on-Amur military works in the Far East. "We need markets," says Vyacheslav A. Nikonov, president of the Polity Foundation, an independent Moscow think tank.

Still, in the eyes of Beijing, the Bush team's Asia blitz looks especially threatening. Signs of a stronger military alliance that would give Japan a role in policing the region are a major jolt. If the U.S. were to strike out of its base in Okinawa, it could cut off vital trade routes. "Shanghai won't be able to get access to its oil supply," frets the editor of a conservative Beijing policy journal. "More and more, Japan now appears as an enemy to China." He fears the Singapore naval pier could have "a real impact on China's security," because U.S. warships there could cut South China Sea shipping lanes.

ON MANEUVERS
Enriched by a booming economy, China's army is getting a makeover

to their globalized economies—and to their relations with their new, powerful neighbor—they could well decide that it's best to keep America at arm's length.

By Brian Bremner, with Chester Dawson, in Tokyo, and with Stan Croc in Washington, Manjeet Kripalani in Bombay, Moon Ihlwan in Seoul, Dexter Roberts in Taipei and Beijing, Paul Starobin in Moscow, and Pete Engardini in New York

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ITALY

Can Berlusconi Renew the Nation?



To his horror, Italian entrepreneur Savino Rizzio discovered last year that Chinese rivals were flooding the global market with counterfeits of his brass plumbing valves—at prices 50% less than he charged. Gazing at the well-made Chinese fake on his desk, VIR founder and President Rizzio conceded that the quality of the counterfeits has improved rapidly. And it's possible for Italy's valve industry to compete with Chinese labor costs, which amount to \$100 a month per worker, compared with \$2,500 a month in Italy. Facing a steady decline in orders, Rizzio must either rapidly develop sophisticated products that are more difficult to knock off or move production out of Italy. "We are really facing hard competition from emerging countries. And we've lost our flexibility," he laments.

Rizzio and hundreds of thousands of other anxious entrepreneurs voted on May 13 for media baron Silvio Berlusconi in the hope that the new Prime Minister will carry out his promise to reverse Italy's declining competitiveness. Across the long-prosperous northern industrial zone, from the foothills of the Alps to the flat plains of the Veneto, Italy's vaunted small and midsize exporters are being hammered by rivals from emerging markets that are making the same products for cut-rate prices. The threat is doubly potent since at home, these Ital-

ian businesses are being throttled by high labor costs, overregulation, an antiquated infrastructure, and an inept public administration.

Of course, Italian businesses have always suffered from a stifling bureaucracy, overregulation, high taxes, and venal public officials. But the country's entrepreneurs survived and even thrived by remaining small and nimble. In the northern industrial districts, manufacturers of the same products, such as textiles or shoes, clustered together like virtual *keiretsu*, purchasing supplies jointly, for example, but skirting inflexible labor laws by employing fewer than 15 workers each. With next to no research spending, they constantly tweaked production processes to keep the number of workers low. They bridged the gaps in skills or education with in-house training. And many simply evaded an oppressive public administration, crushing payroll levies, and high taxes by operating underground—fueling a black market that makes up an estimated 28% of gross national product.

GLOBAL STRENGTH. The result has been an army of small and midsize companies that boast global strength in fashion, industrial design, machinery, and other niche sectors. These companies, like VIR, aren't household names, but they have delivered prosperity to Italy for decades, however chaotic the country has seemed.

But now, Italy's stalwart exporters face obstacles that are proving insurmountable for many of them. "We are caught in the middle" of two new forces, says valvemaker Rizzio. Cheap Asian goods of steadily improving quality are flooding global markets, posing competition Italians have never experienced. At the same time, the rest of Europe is leaping ahead into the digital economy, with companies producing some of the most sophisticated software and telecom products in the world. And Italy? Its businesses, by and large, simply lack the size and research muscle to go against bigger competitors in these technology-driven industries.

Meanwhile, taxes, labor costs, and labor-market regulation have become even more burdensome and restrictive

over the past 15 years. Aging roads and railroads are obstacles to growth. Half-hearted liberalization has left markets in the grip of former monopolies. Worst of all is a

BERLUSCONI HAS PROMISED TO:

- ▶ Cut taxes by a total of \$35 billion
- ▶ Create 1.5 million jobs
- ▶ Boost public-works spending
- ▶ Reform pension system

Data: Forza Italia

International Business

deterioration in the quality of education at every level, the power of courts to function properly, and the ability of hospitals to deliver decent health care.

The price paid for inaction now will be nothing less than the country's economic vitality. Small and midsize companies such as VIR produce more than 80% of Italy's GDP. A weak euro has helped pump exports for the past two years, and forecasts for GDP growth this year are 2.3%. But the fundamental erosion continues apace. In those two years, for example, some 200 textile makers and suppliers around Lake Como have gone out of business, victims of global competition.

It will be hard for tycoon Berlusconi to reverse this decline anytime soon—especially since the fragmented and unstable political system is part of the problem, not the solution. Berlusconi has promised sweeping tax cuts, investment in infrastructure, an end to red tape, and reform of the schools and courts. But his agenda will face resistance from union leaders, bureaucrats, and most likely, his own coalition members. "Italy is starting from a third-world situation," says Eric Chaney, chief European economist for Morgan Stanley Dean Witter & Co.

THE CALIFORNIA OF EUROPE? That's a bitter pill for Italians, who in the mid-1990s believed the promises of politicians that Italy could become the California of Europe—an entrepreneurial economy, attracting talent and capital from the whole world. Instead, many midsize businesses have already saturated their small market niches globally and must move into more sophisticated products to grow. Others are racing to shift production of low-tech goods to eastern Europe and Asia. Geox, a shoe-

maker with a patent on soles with a breathable lining, has outsourced manufacturing to Romania, Hungary, and other cheap locales. With \$190 million in sales, the company employs 6,000 directly and indirectly in low-wage markets and only 300 designers and engineers at headquarters near Venice. "Competition [in Italy] will be harder and harder," says Geox boss Mario Moretti Polegato.

Yet even while traditional industry hollows itself out, Italy seems incapable of producing a new generation of com-

WHERE IS ITALY'S NEXT WAVE OF INNOVATION?

- ▶ It spends 1.84% of GDP on information technology, vs. 4.7% in Sweden and 5.5% in the U.S.
- ▶ R&D spending is 1% of GDP, about half the average among major industrial countries.
- ▶ Venture capital is scarce, with only \$477 million invested in 2000, compared with \$1 billion in France.
- ▶ Technology transfer between universities and industry is nearly nonexistent.
- ▶ It imposes the highest number of administrative obstacles to entrepreneurs.

Data: OECD, EITO (European Information Technology Observatory), European Venture Capital Assn.

panies in cutting-edge industries. Rules governing startups remain hostile, and labor-market rigidities stifle investment. Stock-option regulations have changed four times since the late 1990s.

Even many Italians with capital tend to invest outside Italy. "We'd rather invest in Switzerland. Unfortunately, there is not enough innovation in Italy," says Gian Lucca Braggiotti, founding partner at Milan-based seed fund MyQube. The fund has made only 5 of its 14 investments in Italy and is expanding an office in Geneva to be close to the researchers at CERN, the birthplace of the Worldwide Web.

PRIORITIES

Will Berlusconi be as keen on bolstering the courts as he is on cutting taxes?

Many Italian technology grads and researchers flee to more hospitable countries. Scientist Francesco Paresce bolted in 1995 for the European Southern Observatory near Munich. He was fed up with the lack of professionalism and accountability in Italian research. The reality he left behind: Italy spends only 1% of GDP on research, less than half the level spent by other industrial countries. It produces the lowest number of patents in Europe, pays professors and researchers dismally, and fails to reward performance. "Practically nothing is based on real and measurable merit. It's who you know, not what you know, that counts," says the 61-year-old Paresce.

LOTS OF DROPOUTS. Many students just give up. "The resource I had in England amazed me," says a former architecture student at the University of Naples who quit after two years to complete her education at the University of London. She was fed up with the complicated scheduling, overcrowded lecture halls, nonexistent technical support, and professors who "simply didn't show up for class." Such conditions contribute to a dropout rate of 65%, the highest in Europe.

Italian companies are hard pressed to compensate for the scarcity of workers with top engineering degrees and other computer, telecommunication or technical skills. "There is no question that technology drives growth. If Italy misses the next wave, it will stagnate or fall back over the next 10 years," says Enzo Torresi, a Catania-born serial entrepreneur and venture capitalist who has spent his career in Silicon Valley. Torresi, who left Italy to head Olivetti's advanced-research lab in Cupertino, Calif., for years imported Italy's brightest engineers to the U.S. Of the 60 he hired, 50 remained in the U.S. to start companies.

A new government that can cut the chains that are weighing down the country's entrepreneurs will have a chance to reverse Italy's decline. "There is entrepreneurial capacity to overcome the gap," says Marco Tronchetti Provera, chairman and chief executive of tire maker Pirelli. "We make major changes when our back is to the wall, and we really perceive risk."

The risk is real. If Berlusconi fails to deliver, the cost to Italy will be a generation of lost wealth.

By Gail Edmondson in Valduggia, Kate Carlisle in Forlì, and Sheila Pierce in Rome



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POLITICS NOW, REFORMS LATER: KOIZUMI'S WAITING GAME IN JAPAN

No other Liberal Democratic Party-led government in Japan has enjoyed the stellar popularity ratings of newly elected Prime Minister Junichiro Koizumi's administration. According to a poll released on May 14, more than 90% of eligible Japanese voters surveyed by a major television network approve of the new Cabinet—a sign that the LDP's gamble on the maverick reformer is paying off.

Indeed, Koizumi and other party leaders no longer fear a rout in the upper-house elections scheduled for July 29, a defeat they feared could set the stage for the party's eventual loss of power. The big question now is how the Prime Minister should take advantage of his popularity. In Nagatacho, Tokyo's equivalent of Capitol Hill, speculation is rife that Koizumi may call a snap election of both houses of Parliament to capitalize on his popularity and strengthen his position to carry out reforms. That would be taking a page from his mentor, former Prime Minister Yasuhiro Nakasone. In 1986, he called a joint poll and walked away with a landslide victory.

WATCHING HIS BACK. But old-guard LDP members oppose such a move. Rank-and-file lawmakers in the powerful lower house aren't sure how much of Koizumi's popularity will rub off on them at the polls. Some party elders are still hoping they can depose Koizumi in the next LDP leadership election, scheduled for September. The faction led by Ryutaro Hashimoto, whom Koizumi defeated for the top LDP job in April, is already gearing up for another challenge. "The Hashimoto faction is biding its time, waiting for an opportunity to pounce if Koizumi trips up," says Teruaki Izume, a director of Mitsui Kaijyo Research Institute who closely follows Japanese politics.

So Koizumi has to watch his back, even as he mulls his next move. If he sticks to his word, he is expected to push hard for the LDP to gain a safe margin of seats in the upper

house in July and use that victory to secure his position in the LDP leadership vote in the fall. In the meantime, the challenge will be to stave off complacency toward reform now that chances for a rout at the polls suddenly seem remote.

Koizumi will likely play it safe until the dust settles after the July vote. He'll want to avoid the pain that could turn voters away from the LDP if he moves on proposals to deal with bad loans plaguing the banking sector or Japan's declining competitiveness. "There won't be any reforms before

the election," says one LDP lawmaker. Yet Koizumi will still raise tough issues to signal where he's headed. In mid-May, for example, he told the Labor Ministry to look into ways to loosen up restrictions that make it hard for companies to fire workers and hire temp staffers as replacements.

To prepare for implementing his agenda later, Koizumi is reaching out to a wide range of constituencies—including the opposition. In fact, the Prime Minister has succeeded in stealing much of the thunder of the chief opposition party, the Democratic Party of Japan. He has even gone so far as to call for joint passage of crucial economic legislation. And he is raising issues that could attract defectors from the DPJ. For example, he's calling for allowing the country's armed forces to fight outside Japan, which has been taboo since the postwar con-

stitution took effect in 1947. That issue is dear to the hearts of many DPJ members, including party chief Yukio Hatoyama.

If Koizumi's tactical political maneuvers over the next few months fail, he may find himself out of a job in September. But if the political instincts that brought him to power stay sharp, Japan may finally have a leader who is strong enough—and wily enough—to push through reforms. Either way, it will be a long, tough summer of politicking in Japan.

By Chester Dawson in Tokyo



KOIZUMI: Popular premier

GLOBAL WRAPUP

GAZPROM LOOKS TO UKRAINE

► With Russian President Vladimir V. Putin's recent appointment of former Prime Minister Viktor S. Chernomyrdin as ambassador to Ukraine, the stage is set for Russia to establish economic dominance over the impoverished former Soviet republic. The expected vehicle for the takeover: Gazprom, the Russian gas monopoly that Chernomyrdin once headed. It is seeking to acquire prime industrial assets in Ukraine in exchange for cuts in up to \$2 billion in unpaid gas bills

owed to the company. Chernomyrdin is expected to strike a debt-for-equity deal and to knit closer political ties between Russia and Ukraine. Gazprom has its eyes on everything from steel plants to oil refineries, says analyst Roland Nash of Moscow brokerage Renaissance Capital.

A BLOW TO DEUTSCHE BANK

► A team of top capital-markets executives from Deutsche Bank has defected to rival Barclays Capital, the investment-banking wing of Barclays Bank. Among those joining Barclays

are Grant Kvalheim, who was head of global debt issuance, and European bond chief John D. Winter. At least 10 Deutsche executives are moving to Barclays. The defections appear to be fallout from the death last year in a plane crash of Edson Mitchell, Deutsche's head of global capital markets. Kvalheim was a close friend of Mitchell's. Competitors say the departures will be a blow to Deutsche's efforts to remain atop the global bond league tables. The bank's strong position in German domestic bonds, though, is unlikely to be threatened.

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SOFTWARE

IBM VS. ORACLE: IT COULD GET BLOODY

Now, for every Oracle product, IBM has a counterpunch

Ask Oracle Corp. CEO Lawrence J. Ellison what keeps him up at night, and the answer might surprise you. It's not his longtime nemesis, Microsoft Corp. It's not up-and-comer Siebel Systems Inc. It's IBM, the awakening tech giant that is vying for the No. 1 spot in the corporate-software world. "He has stopped with that 'Microsoft is the devil' stuff," says Steve Mills, IBM's software head. "He has moved on to us."

With good reason. Whoever wins in this face-off will grab the lion's share of the \$50 billion corporate-software market for years. For every Oracle product, IBM has a counterpunch: Databases, applications, and e-business foundation software. At the same time, the companies' philosophies are strikingly different. Oracle's strategy is to offer customers a complete and tightly integrated package of software—everything a company needs to manage its finan-

cials, manufacturing, sales force, logistics, e-commerce, and suppliers. In contrast, IBM Chairman and CEO Louis V. Gerstner Jr. is backing a "best-of-breed" approach in which it stitches together a quilt of business software from various companies, including itself.

The outcome of this battle has huge implications for the software industry. If IBM's partnering strategy carries the day, it means there will be plenty of breathing room for major application makers such as SAP, Siebel, and PeopleSoft, and for countless upstarts that are bringing Internet programs to market. If Oracle gains the upper hand, it will

HUGE STAKES

If Gerstner pulls ahead of Ellison, it will create more room for major application makers and upstarts

be pushing its own applications, leaving less room for other players.

To get ahead, IBM is targeting what it sees as Oracle's chief vulnerability: The Silicon Valley company competes in the applications market with the same software makers it relies on to help sell its databases. IBM has an advantage because it doesn't sell applications of its own. So, by setting itself up as a neutral party, IBM is able to gain those companies as allies. That boosts its database sales, since application companies often recommend to customers which database they think should be used with their software. IBM's consultants then sew the software together.

Analysts are split on whether Oracle's or IBM's strategy will succeed long-term. They expect both companies to remain among the strongest players in the market. But competitive juices are flowing. Ellison has only disdain for the idea of corporations buying major software components from different

DUELING STRATEGIES While Oracle offers tightly integrated all-Oracle packages, IBM knits together software from a variety of vendors

suppliers and then hooking them together. "You would never buy a car that way," he says.

Yet IBM's momentum is undeniable. Take Oracle's flagship database business. Sure, Oracle is still in the lead in the non-mainframe piece of the market, with a 50% share, according to AMR Research. But Oracle's database sales have stagnated over the past two quarters, while IBM's are surging. In the most recent quarter, IBM's sales on high-end computers running the Unix operating system jumped 36%, while Oracle's grew just 6%. And thanks in part to the \$1 billion acquisition of Informix Corp. on Apr. 24, IBM is now the second-largest maker of non-mainframe database software, with a 25% share.

Ellison, however, is worried about more than databases. Consider the e-business software dubbed "application servers"—a foundation of e-commerce software that processes transactions and connects to back-end programs such as databases. As a result of an early jump in the business, IBM owns 30% of the market—three times Oracle's share—according to Giga Information Group Inc. "The problem is that we didn't have a very good product until recently," concedes Oracle Chief Financial Officer Jeffrey O. Henley.

WAY BACK. There's a lot of history between Oracle and IBM. In 1970, IBM researchers wrote the first paper on so-called relational databases, creating a programming language, called SQL, that for the first time allowed people to analyze, rather than just store, computer information. IBM applied this research to its then-thriving mainframe-database business. That allowed Ellison, then a young mainframe programmer, to exploit its potential in the emerging market for Unix systems.

In the late 1980s, a new wave of business software companies, led by SAP, helped boost Oracle's fortunes. They built their software to run on Oracle databases even though Oracle sold its own competing applications software.

In the mid-1990s, analysts estimate that those software companies helped drive at least 25% of Oracle's database sales.

IBM's key move was getting out of the application business in late 1999. That freed Big Blue to focus on providing infrastructure technologies, such as databases, and to partner with companies that were leading players in various application markets, such as sales-force automation or supply-chain management.

The new partnership strategy is like

TALE OF THE TAPE

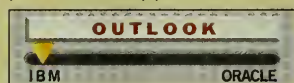
For years, IBM and Oracle were like two bullies who played in the same sandbox but rarely bumped into each other. Now, they are increasingly butting heads, competing in nearly every part of the e-business software market. Here's how they stack up:

DATABASES IBM owns the mainframe-database business, and Oracle is the heavyweight everywhere else, with a 50% share on Unix servers. Now, IBM is coming on strong. Thanks to its acquisition of Informix in April, Big Blue has a 25% market share.



☐ Oracle by a long shot, though IBM is gaining ground.

INTERNET INFRASTRUCTURE SOFTWARE IBM was one of the first to jump into this nascent market. It is the second-biggest provider of application servers, with market share of about 30%.



Oracle has a 9% share.

☐ IBM hands down. Oracle is going to have a hard time catching up.

ENTERPRISE APPLICATIONS Oracle's new e-commerce applications have had moderate success. Sales of its business software grew a healthy 21% last quarter. Big Blue has decided to stay out of the apps biz, instead partnering with Oracle's rivals.



☐ A draw. Oracle is picking up steam, but IBM has more friends.

a pincer movement against Oracle. In the past 18 months, IBM has signed 59 alliances with application makers such as Siebel Systems, Ariba, and PeopleSoft—all Oracle rivals. Many of them, long under Oracle's thumb, are happy to align with a company they don't compete with. "I will not help Oracle make a single dime that I don't have to," says Rick Berquist, a senior vice-president at PeopleSoft.

To be sure, Oracle remains an important partner. PeopleSoft and companies like it still sell a majority of their software to run on Oracle's databases. But IBM is catching up. In 2000, the percentage of Siebel projects that included IBM's database jumped from 2% to 30%, while Oracle's share dropped from 81% to 60%, according to Siebel.

And IBM is just getting started. On

May 14, the company announced that its Internet-infrastructure software will soon support Net standards that make it easier to connect disparate computing systems. That means customers won't have to rip out old systems to do e-commerce. "IBM is jumping on this growing business early," says Peter Urban, a senior analyst at AMR Research. And don't forget those partnerships. In a few years, IBM expects to sign up hundreds more Net-infrastructure software partners, many of which will compete against Ellison & Co.

The tech titans have even taken their fight to the streets. Three months ago, IBM rented a billboard near Oracle's Silicon Valley headquarters declaring a "search for intelligent software," only to find, a few days later, that an Oracle billboard retorting "Then you've come to the right place. Oracle," had been put up.

WHO'S CHEAPER? The latest fracas is over pricing. Ellison derides IBM software as nothing more than a come-on to sell "services, services." While IBM typically sells its database software at nearly a fifth the price of Oracle's, Ellison says the consulting work to get it up and running makes IBM products pricier. Some customers beg

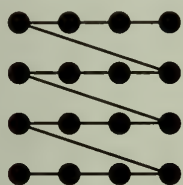
to differ. Recently, the Toronto Police Service switched from Oracle to IBM database software. Chris Pentletown, a longtime consultant to the police service who recommended the switch, says Oracle's database was three to five times as expensive as IBM's, including IBM's service fees. "We could not afford to run Oracle anymore," says Pentletown.

To forestall more damage, next month Ellison plans to introduce the new version of his database, and analysts say the easier-to-use update should cut maintenance costs. Don't bet against IBM, though. It is, after all, the world's second-largest software company. And its new partnering strategy looks like the beginning of a long night mare for Ellison.

By Jim Kerstetter in Redwood Shores Calif., and Spencer E. Ante in New York

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A positive relationship cannot exist without communication. Research shows that kids believe they have valuable things to say. When mentors ask them and listen genuinely, **it helps build self-esteem and confidence.**



Communication is connection. During their teenage years, kids are exposed to an ever widening variety of people and influences. Know their friends and their routines. Tell kids that you care about them. Praise them when they do well, no matter how small the accomplishment. Get involved and encourage your colleagues to do the same. Stay connected.

Also it demonstrates that you support their burgeoning independence as well as their ability to make intelligent decisions. The important thing to remember about drugs is that **it's not a five minute talk. It's a dialogue.** As kids grow, they will need more information relevant to their exposure. In general, smoking marijuana is harmful. The younger a kid is, the more it may be. Research shows that people who smoke it before age 15 **are 7 times more likely to use other drugs.** It also

shows that people who didn't smoke marijuana by age 21 were more likely to never smoke it. For more information, visit www.theantidrug.com or call 800.788.2800.

Getting to know kids and staying involved with them is one of the most effective drug deterrents. Through their teenage years, this is not always easy. Even still, research shows that kids still want this to happen, even as they are exploring and growing into their own individuality. One way to do this is to get your business involved and plan activities in your community. This message is brought to you by the Office of National Drug Control Policy/Partnership for a Drug-Free America.

On a summery afternoon in early May, Tyco International chief executive L. Dennis Kozlowski strode into the New Jersey board room of his latest prey, CIT Group Inc., the nation's largest independent commercial finance company. Technically, CIT was not yet in Kozlowski's grip: Tyco's \$9.2 billion offer wouldn't come up for a shareholder vote for another three weeks, and the deal wasn't expected to close until June 1. But as he huddled with CIT CEO Albert R. Gamper Jr., Kozlowski made clear he was already impatient for Gamper to get with the Tyco program. "It is crucial that we push growth coming out of the box," Kozlowski said, pressing for dramatic action that CIT could take as soon as the deal closed. "I want people to say, 'Wow, this is a real step up.'"

Kozlowski stunned investors and executives with his bid for CIT—an outfit that, ironically,

once rejected him for a low-level auditing job. Skeptics question what an industrial conglomerate specializing in such mundane products as valves and garbage bags can possibly bring to the competitive world of commercial finance. It's a field that has proven to be a veritable graveyard for expansion-minded CEOs. "Kozlowski is putting his toe [into an area] that ostensibly he doesn't know anything about," says former AlliedSignal CEO Larr

Bossidy. And he's doing it at a time when even Gamper warns that a softening economy is producing "a

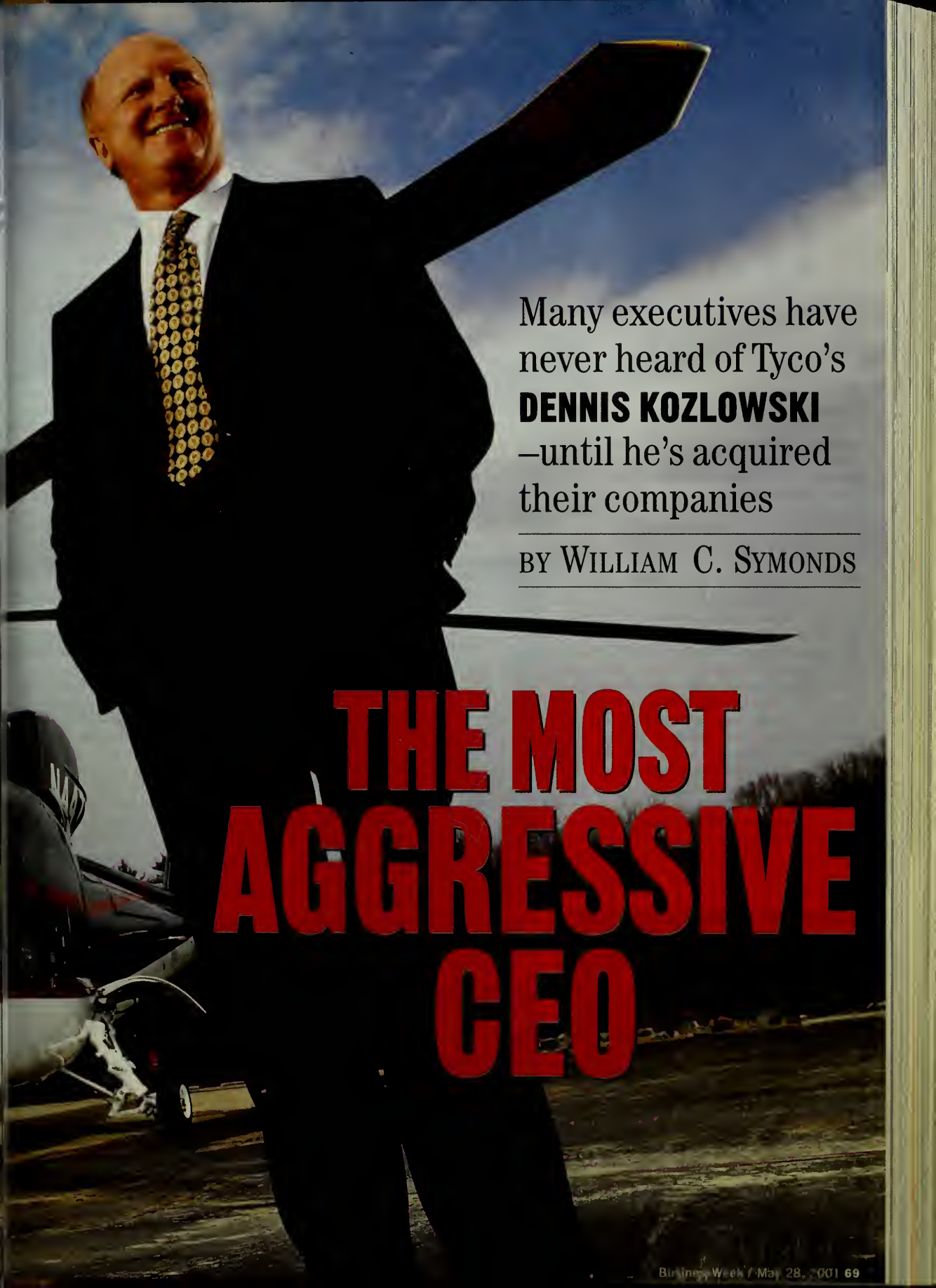
credit world that is tougher today than a year ago." But Kozlowski is undaunted. He predicts that under Tyco, CIT will double in size within a few years and achieve earning growth of 15% a year. Says Kozlowski: "I think CIT will be one of the best deals we've ever done."

Coming from most CEOs, such talk would be dismissed as hubris or worse. But

Management

KOZLOWSKI LIVES IN A MODEST HOME BUT PILOTS HELICOPTERS, PLANES, AND YACHTS



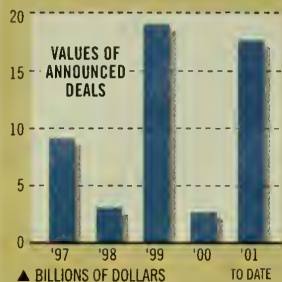
A full-page photograph of Dennis Kozlowski, CEO of Tyco, smiling and looking upwards. He is wearing a dark suit, a white shirt, and a patterned tie. He is standing on the wing of a private jet, with the tail fin visible behind him. The background shows a clear blue sky with some light clouds.

Many executives have
never heard of Tyco's
DENNIS KOZLOWSKI
—until he's acquired
their companies

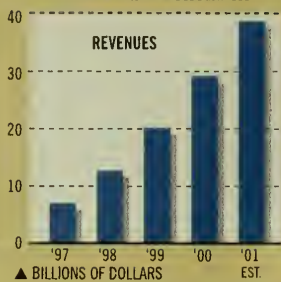
BY WILLIAM C. SYMONDS

THE MOST AGGRESSIVE CEO

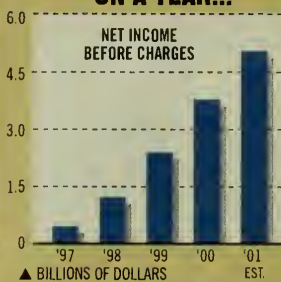
AS KOZLOWSKI GOBBLES UP COMPANIES...



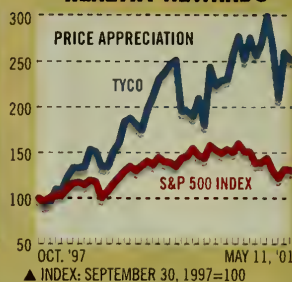
...TYCO'S SALES HAVE SOARED...



...AND EARNINGS ARE ON A TEAR...



...GIVING INVESTORS HEALTHY REWARDS



Data: Tyco International Ltd., Merrill Lynch & Co., Bloomberg Financial Markets

Kozlowski has made a career of confounding the critics. Since taking the reigns at Tyco in mid-1992, the son of a Newark detective has become one of the most aggressive CEOs in the land—spending some \$53 billion on 120 major acquisitions, most of which have been folded seamlessly into Tyco's hyperefficient operations. That plus a willingness to test the limits of acceptable accounting and tax strategies have transformed the \$3 billion also-ran outfit he inherited into a colossus that will ring up \$38.5 billion in sales in the fiscal year ending Sept. 30, including a quarter of CIT's sales.

With earnings rising even faster, Tyco recently vaulted to the top of the *Business-*

Week 50 ranking of top-performing companies. isn't modest in stating his goals. "Hopefully, we can become the next General Electric," Kozlowski muses in his Exete (N.H.) office as his helicopter waits outside to whisk him to yet another dealmaking session. He wants to be remembered as "some combination of what Jack Welch put together at GE...and Warren Buffett's very practical ideas on how you go about creating return for shareholders."

THE SIZE BARRIER. To attain that summit, Kozlowski must surmount some formidable challenges. First is his business model, which anticipates ever more acquisitions. "To keep up this tremendous growth, they'll have to do bigger and bigger deals that entail bigger and bigger risks," warns Harvard Business School Professor Robert Kennedy, who has written a case study of the unusual home-grown culture behind Tyco success. Looming over Kozlowski's strategy is the simple fact that sooner or later, virtually every U.S. conglomerate that's aspired to these heights has imploded. "ITT and AT&T are great exemplars of companies who've been forced to break up," cautions Michael Useem, professor of management at Wharton. "GE is the exception to the rule that conglomerates in the American market have not worked well."

That's one reason Tyco is such a fat target for skeptics. But Kozlowski also faces more pointed questions about Tyco's financial credibility. As 1999 ended, he was on the ropes over accusations that he had used accounting tricks to pump up Tyco's results. The charges, first leveled by short-seller and accounting analyst David W. Tice of David W. Tice & Associates, cut Tyco's stock in half and prompted a Securities Exchange Commission inquiry. The SEC ended its investigation last July without taking any action, but the lingering taint is one reason Tyco's stock garners such a low price-earnings multiple. At \$53 a share, it's selling at just 18 times this year's expected earnings. That compares with GE's p-e of 30.

Management

Week 50 ranking of top-performing companies.

Kozlowski, who relaxes by piloting his 130-foot J-class sloop, *Endeavour*, in international regattas, so far has managed to sail smoothly through the economic slowdown. In the first quarter, the worst in a decade for U.S. corporate profits, Tyco's earnings soared 33% on a 26% jump in sales. As a result, Tyco, with its decidedly unglamorous product lineup, is now worth roughly \$93 billion, more than Ford Motor Co. and General Motors Corp. combined. And the scary thing is, at 54, Kozlowski seems to be just getting started. "Dennis has more fire in his belly today than the day he became CEO," says Joshua M. Berman, Tyco's former outside counsel and a board member since 1967.

Kozlowski's ambitions stretch far beyond his audacious five-year plan of adding another \$50 billion of acquisitions and reaching \$100 billion in sales while maintaining 25%-plus annual earnings growth. He aspires to nothing less than guru status, the sort of peer recognition that would once and for all put behind him an army of short-sellers and other critics. He

THE STEALTH CONGLOMERATE

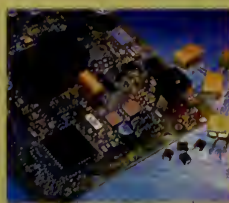
One reason for Tyco's low profile is its decidedly unglamorous but fast-growing roster of businesses. Here's what the mix will look like after Tyco's deal to buy CIT Group goes through:

TOTAL 2001 SALES*
\$38.5 billion

*Sales are estimates for fiscal year ending Sept. 30, assuming ownership of CIT for one quarter
Data: Tyco International, Merrill Lynch

ELECTRONICS

\$13 billion sales



Components, including connectors, switches, and sensors

HEALTH CARE

\$9 billion sales



Syringes and wound-care products; includes plastics unit that makes garbage bags and sheeting

FIRE, SECURITY SYSTEMS

\$8 billion sales

Fire protection and electronic security, including ADT



and is only 0.8 times Tyco's expected five-year growth rate—half the 1.7 ratio for the much slower-growing Standard & Poor's 500-stock index. "That is very unusual," says Charles J. Hill, director of research at First Call Corp., "and it raises the question of why?" Kozlowski's answer: "It will take more quarters of pounding out good earnings and cash flow" to convince investors to pay up for Tyco.

Tyco's obscurity doesn't help the stock price either. Despite its dramatic growth, it remains less well known than companies like Boeing, Hewlett-Packard, or Merrill Lynch, all of which have lower market capitalizations. Even Gamper concedes that while he had been expecting takeover overtures for CIT, "never in my wildest dreams had I thought of the name Tyco." Once Kozlowski approached him, Gamper asked KPMG and Credit Suisse First Boston to give Tyco a thorough review. Gamper says he came away impressed—and he isn't alone. "He's made dramatic progress in building a major industrial conglomerate," says Bossidy. That's high praise, coming from a man whose 1998 bid for AMP Inc., the world's leading maker of electronic components, was trumped by Kozlowski's \$11.3 billion offer. "He is aggressive," Bossidy says. "But so what? I don't find that offensive."

Recently, Kozlowski also has sought to nurture an image as a leader among peers. He is chairman of the M&A Group, a recently formed club of about 60 CEOs that sees itself as a more useful alternative to such traditional CEO gatherings as the Business Roundtable. Says Robert Monks, an institutional-shareholder activist who served on the Tyco board: "I don't think there's a better CEO in America."

Kozlowski's signature contribution to management theory is his highly systematized method for identifying, assimilating, and wringing growth out of acquisition targets (page 70). He relies on a hand-picked team of six in-house M&A specialists that moves with blinding speed and uses outside investment banks sparingly. "Investment bankers will tell you it takes six months to do a deal; we often get them done in two weeks," says Irving Gutin, a senior vice-president who until recently headed the team. Tyco screens more than 1,000 potential targets a year, most of which filter up from its operations executives. It doesn't do hostile takeovers, since that would keep it from getting a thorough look inside. Once it has a con-

fidentiality agreement with the target company's CEO, Tyco's team pores over the books and tours operations, looking closely at what—and who—is worth keeping. That almost always means lopping off the incumbent CEO. (Gamper would be an exception: He's been offered a three-year contract.) Only deals that add immediately to Tyco's bottom line go on to completion. Says Gutin: "Dennis doesn't want to buy dreams."

NOT A GAME. Typical is his 1994 purchase of Kendall, a maker of low-tech medical supplies. Kozlowski stunned the industry by offering \$1 billion for the financially troubled company. "Everyone was asking, 'Who is Tyco?'" recalls Richard J. Meelia, a Kendall executive who has since risen to president of Tyco Healthcare Group.

"The first response was, the toy company"—that is, Tyco Toys, maker of Tickles Me Elmo.

No wonder. At the time, Tyco's minuscule medical business had perhaps \$50 million in sales, vs. \$600 million for Kendall. Kendall execs were even more aghast when Kozlowski said he wanted to build Kendall to \$3

billion in three years. It was an insane target for an old-line company that had managed to buy only two companies with \$50 million in sales in two years. But after gobbling up such medical-products giants as U.S. Surgical, Sherwood, and Mallinckrodt, Tyco Healthcare will ring up \$7 billion in sales this year, predicts Merrill Lynch & Co. analyst Phua Young. It is now compared with the likes of Johnson & Johnson. "They've done a terrific job of consolidating certain segments of the medical market," says John Strong, CEO of Consorta Inc., a hospital purchasing cooperative.

At a time when at least half of all U.S. mergers founder, one reason Tyco so rarely stumbles is that it develops a detailed game plan for integrating each acquisition before

ALBERT R. GAMPER JR.

Chairman and CEO, CIT

Though he expected takeover suitors, "never in my wildest dreams had I thought of... Tyco"



CIT GROUP »

\$6 billion sales*

2nd-largest commercial insurance company in the U.S.



*Sales estimate for 12 months

FLOW CONTROL »

\$4 billion sales

Industrial valves and controls



TYCON »

\$3 billion sales

Makes and installs undersea communications systems for the telecom industry, building a global network



BIGGER AND BIGGER *Kozlowski is taking Tyco down a road littered with broken-up industrial conglomerates*

the deal even closes. With AMP, that plan was hammered out in a secret meeting in Germany with Jürgen W. Gromer, then AMP's head of sales, whom Kozlowski had tapped to take charge. CEO Robert Ripp, who left AMP once the deal closed, wasn't invited. In the first two days after the contracts were signed in April, 1999, Gromer reorganized the struggling company, firing 60 of 66 vice-presidents and unveiling plans to cut \$1 billion in costs in 18 months. Now highly profitable, AMP has been gobbling up

weaker players such as Lucent Power Systems. "They've done quite a job turning around AMP," marvels Fred Krehbiel, co-chairman and co-CEO of Molex Inc., Tyco's largest competitor in connectors.

With CIT, Kozlowski has once again climbed onto the high wire. If it turns out the operation doesn't smoothly fit into Tyco's industrial mix, Kozlowski's growth machine could splutter. Tyco is just the latest of a long line of industrial companies—from Westinghouse Electric to AT&T, ITT, and Tectron—that have been lured into costly forays in financial services. "You just need to look back in history and see how all those other companies did," warns one senior financial-services industry executive. "Most have failed because they took on too much risk...and didn't understand the business."

Yet as Tyco's board mulled CIT, that sorry history was eclipsed by one stunning exception: General Electric Capital Services Inc. Kozlowski says the Tyco board had been looking to add a finance arm for nearly four years. "But there had always been a fatal flaw" with possible targets, he says. Then late last year, director Frank E. Walsh Jr. suggested that CIT's Gamper—whom he's long known—might be ready to deal. In December, Walsh arranged a private lunch to introduce the two CEOs.

DOWN, NOT OUT. Like many of Tyco's targets, CIT was a fundamentally solid company going through a rocky period. Under Gamper, who's been in charge since 1987, it built a reputation as a blue-chip lender financing everything from the rag trade to planes, trains, and the big earth-moving equipment known as yellow iron. With \$54 billion in assets, it ranks behind only GE Capital and Citigroup Inc. in commercial finance. It's also the largest U.S. factor, or purchaser of receivables from textile and apparel makers, which means it is knee-deep in a slow-growth business. But in 1999, CIT busted out of its conservative mold by acquiring an aggressive Canadian upstart, Newcourt

Credit Group of Toronto. Overnight, CIT doubled in size but was soon choking on unfamiliar businesses such as international lending and tech financing. CIT's shares fell to a low of \$13 last fall, half the price at which it had gone public in 1997. Little wonder Gamper leapt at Tyco's offer of \$35 a share.

Kozlowski has a three-pronged plan to Tyco-ize CIT. For starters, he's pressing Gamper to swiftly sell or liquidate more than \$4 billion in underperforming loans. Meanwhile, CIT sidelined since it bought Newcourt, will aggressively hunt for acquisitions in its still-fragmented industry. And he's appointed J. Brad McGee—a former Marine and one of his most trusted lieutenants—to help CIT finance Tyco's customers. After some two dozen meetings between CIT and Tyco business units, McGee argues CIT could finance everything from \$75 million wastewater treatment plants built by Tyco to monthly lease plans for customers of its ADT home-security unit. In all, he figures such financing could boost Tyco's sales by \$4 billion to \$6 billion a year.

But in the conservative world of commercial lending, such a go-go approach could backfire. True, the auto industry has long financed its customers. But other captive finance companies have "often [been] a recipe for disaster," warns banking consultant Bert Ely of Ely & Co. in Alexandria, Va., especially if they become a lender of last resort. Loans to customers turbo-charged growth during boom times for Lucent Technologies Inc., for instance, but burned when the slowdown hit. Ely notes that GE Capital finances just 2% of its parent's industrial sales: "GE Capital has done as well as it has because it had a much higher degree of financial independence."

Kozlowski says he's well aware of the dangers and vows to maintain CIT's A+ rating from Standard & Poor's. "I give him the benefit of the doubt, based on his track record," says Keith DeVore, an analyst at American Express Financial Advisers Inc., one of Tyco's largest shareholders. But Kozlowski will have to tread carefully. "If they stick to their knitting and let Gamper run it, they'll be fine," says a senior finance executive who has competed with CIT for years. "But Kozlowski doesn't seem to be a very patient guy."

That's an understatement. The gamble comes hot on the heels of Kozlowski's biggest crisis, the controversy over Tyco's liberal use of merger-related charges. In an October, 1999, report, analyst Tice suggested Tyco might be creating "cookie jar" reserves that could be used to inflate profits. Although Kozlowski vehemently denied any wrongdoing, proving that to investors was almost in-

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THE KOZLOWSKI METHOD

Tyco buys well over 100 companies a year, using what amounts to an in-house investment bank—six professionals who work with CEO Dennis Kozlowski on each deal. They move with blinding speed, typically taking six weeks, vs. a more standard six months, and follow a five-step process:



PROSPECTING Each year, Tyco looks at more than 1,000 possible targets, ranging from small home-security firms to giants like CIT. The best ideas usually come from Tyco's operating managers.

FIRST PASS Each potential acquisition is reviewed by the appropriate operating unit to determine if it would fit into Tyco's mix. Half of all targets are eliminated at this stage.



DUE DILIGENCE Tyco signs a confidentiality agreement with the target; it never makes hostile bids. A team arrives to tear apart operations and books. Another 40% of candidates are cut.



NEGOTIATION Every deal must immediately add to Tyco's earnings. If the price of the target company rises beyond that point, Tyco walks.

IMPLEMENTATION As soon as terms are reached, Tyco's operating people swarm the new company to develop a turnaround plan. Their orders: to start executing the plan the day the deal closes.





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possible because Tyco's financial statements are so devilishly complex. Says Harvard's Kennedy: "I think Tyco got an incredibly bad rap but then handled it about as well as they could." By the time the SEC showed up in December, 1999, Kozlowski knew that a regulatory review might be his best option. Tyco was clearly a top priority for then-SEC Chairman Arthur Levitt Jr., who was crusading against accounting abuses. But last July, after seven months of digging, the SEC dropped its investigation without taking any action beyond its earlier demand that Tyco change the timing of certain charges. SEC officials don't dispute Tyco's statement that the matter is closed.

Kozlowski's nonstop dealmaking has also raised questions about how dependent Tyco's growth is on acquisitions. But he maintains that internal growth alone is increasing earnings by better than 20% a year. The businesses may not be exciting, but they're nearly all

Management

in fragmented fields with solid growth. Revenues in the health care and electronics industries are growing around 8% annually; in security, it's 11% to 12%. And though Tyco ranks first or second in virtually all of its businesses, it still has enormous room to expand.

Tyco managers have become ruthless at stealing market share. Take plastic garbage bags. When Tyco acquired the maker of Ruffies in 1996, it was a lethargic No. 3 brand, earning minimal margins of about 5%. Tyco moved swiftly to cut costs, boost customer service, and introduce new products, such as a baking soda bag to limit odors. The result? Ruffies is now No. 1, having vaulted past Glad and Hefty Bags, and has tripled margins to 16%.

TAX MASTER. Kozlowski is just as aggressive in pursuing financial advantages. When Tyco snapped up Bermuda-based ADT, he structured the deal as a reverse merger, moving Tyco's headquarters to an island haven where the corporate tax rate is zero. The deal initially ignited a firestorm among shareholders, who had to pay capital-gains taxes on the transaction. But it has become a gold mine for the company. Because of its Bermuda base, Tyco no longer pays U.S. taxes on its growing overseas income. Tyco also has set up a Luxembourg-based subsidiary to finance most of Tyco's debt. In a process known as income-stripping, the Luxembourg subsidiary makes loans to Tyco units in the U.S. and elsewhere, which then deduct the interest payments from their taxable income. Together, these ploys sliced Tyco's effective tax rate to 25% last year, from 36% the year before the ADT deal. That saved \$500 million-plus in taxes last year alone, or more than Whirlpool Corp. earned. "There is no question about the legality of this," says Louis Feldman, an expert on cross-border taxation at Credit Suisse First Boston, though he says Tyco is probably the largest outfit to go offshore.

Legal, it may be, but it doesn't look very good for a guy who aspires to the Jack Welch mantle. "Tyco is the equivalent of the Benedict Arnold billionaires who have moved offshore," fumes Bill Allison, senior editor at the Washington-based Center for Public Integrity. "They're turning their backs on the American people." Tyco says that it pays far more in U.S. taxes today than before its merger with ADT.

As Tyco's low p-e proves, many skeptics still doubt that Kozlowski, even with such gimmicks, can keep growing at a breakneck pace. "There will be a stumble, and it's coming soon," predicts analyst Tice. He and others are alarmed that Tyco's debt soared to \$18.3 billion on Mar. 31, up from less than \$1 billion in 1996, pushing its debt-to-total-capital ratio to 47%, from 25%. "What concerns me is the absolute levels of debt and the possibility there will be poor integration of a large acquisition," says George A. Meyers, an analyst at



L. DENNIS KOZLOWSKI

BORN Nov. 16, 1946, Newark, N.J.

CHILDHOOD Raised in apartment building in blue-collar neighborhood; father was a police detective.

EDUCATION BS, finance and accounting, Seton Hall University, 1968.

COLLEGE FINANCES Lived at home to save money, played guitar in a band that performed at weddings.

CAREER PATH Started as an auditor for conglomerate SCM. Finance jobs at Cabot and Nashua before joining Tyco in 1975. Rose to CEO in July, 1992.

TYCO STAKE Owns 12.7 million shares, worth some \$675 million.

MAJOR-LEAGUE HOLDINGS Has minority share in Yankee Nets consortium that owns the N.J. Nets, Devils, and N.Y. Yankees. Rarely attends games.

GOAL FOR TYCO "Hopefully, we can become the next GE."

HOBBIES Logs 250 hours a year piloting helicopters and a Beech Baron plane, races his antique 130-foot



J-class sloop *Endeavour* (left and above).

FAMILY Divorced; two daughters, who are pursuing MBAs at Harvard and Columbia.

Moody's Investors Service. But he says that is offset by rising free cash flow, expected to top \$4 billion this year. The mostly stock-financed purchase of CIT will actually reduce Tyco's leverage. As a result, both Moody's and Standard Poor's have Tyco on credit watch for an upgrade.

Kozlowski has been in a hurry ever since growing up in six-family apartment building in a blue-collar, ethnic neighborhood in Newark's inner city. Since his father, a police detective, couldn't afford to send him to college, Kozlowski lived at home and worked 30 hours a week to pay the tuition at Seton Hall University. His main source of income: playing guitar in a band whose gigs ranged from Polish weddings to stunts on the Jersey Shore. While majoring in accounting, Kozlowski found time to take flying lessons and now logs 250 hours a year piloting Tyco's helicopter and his personal plane.

After graduating in 1968, Kozlowski headed to New York

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as an auditor in the M&A department of CM Corp., a conglomerate snapping up everything in sight. Itching for more responsibility, he jumped to more senior finance jobs at chemicals company Cabot Corp. and office-products marketer Mashua Corp. Kozlowski came away convinced that he could do a far better job. He got his chance in 1975 when a recruiter lured the 28-year-old to a meeting with Joe Gaziano, CEO of Tyco, then a diversified manufacturer with just \$15 million in sales. But Gaziano, a bear of a man who shaved his head daily, told Kozlowski he wanted to build it to \$1 billion through purchases. Kozlowski's job: cleaning up Tyco's troubled acquisitions. That included Grinnell, a money-losing re-protection company that Tyco bought from ITT. Grinnell epitomized ITT's bureaucratic culture. Field managers spent one week a month in meetings at headquarters. In his first week, Kozlowski scrapped the meetings and shrank the corporate staff to 30 from 200.

It was the precursor to what today may qualify as the leanest operation in corporate America. Kozlowski oversees a 205,000-employee empire with a corporate staff of just 140. He still operates out of the modest, two-story wooden building in Exeter, N.H., that Tyco built when it had \$100 million in sales, even though the company is officially based in Bermuda. "If you build an elaborate headquarters, people are tempted to spend a lot of time there and it becomes really unproductive," Kozlowski reasons. And perks such as country-club memberships and executive dining rooms are taboo. Kozlowski himself keeps a low social profile. His primary residence remains a 3,500-square-foot house on the coast in Rye, N.H., that he bought 15 years ago, although he now keeps a summer home

Management

Nantucket and a place in Boca Raton, Fla. In Tyco's entrepreneurial culture, managers have enormous autonomy. Kozlowski relies on a computerized reporting system that gives him a detailed snapshot of how each business is performing. It's updated several times a week with information including sales, profit margins, and order backlog, organized by geography and product area. If he spots a problem, Kozlowski invariably uses the phone rather than e-mail. "If you're on forecast, there's no need to talk with me," he tells managers. "But if there is any bad news at all, find me wherever I am, so we can figure out what actions to take." He doesn't have a quick temper, but those who don't deliver don't last.

Kozlowski seeks out managers not from the same mold as himself: someone who is "smart, poor, and wants to be rich." He keeps them motivated with a demanding compensation plan. Tyco executives don't receive bonuses unless they come close to meeting the aggressive earnings targets set by Kozlowski: typically about 15%. If they hit the target, they'll get a bonus at least equal

DAVID TICE

David W. Tice & Associates

This longtime Tyco critic and short-seller says: "There will be a stumble, and it's coming soon"



last year's 42% rate. And not all of Kozlowski's bets are clear winners. Tyco entered the undersea cable business in 1997 when it bought an AT&T unit. TyCom Ltd. has since more than doubled sales, to \$2.5 billion last year, but a \$5 billion investment in its own global cable network could drag down future results. "There is a glut of undersea capacity," warns Qwest Communications International Inc. CEO Joseph P. Nacchio. TyCom's stock, sold publicly last year to help finance the network, is 64% off its high.

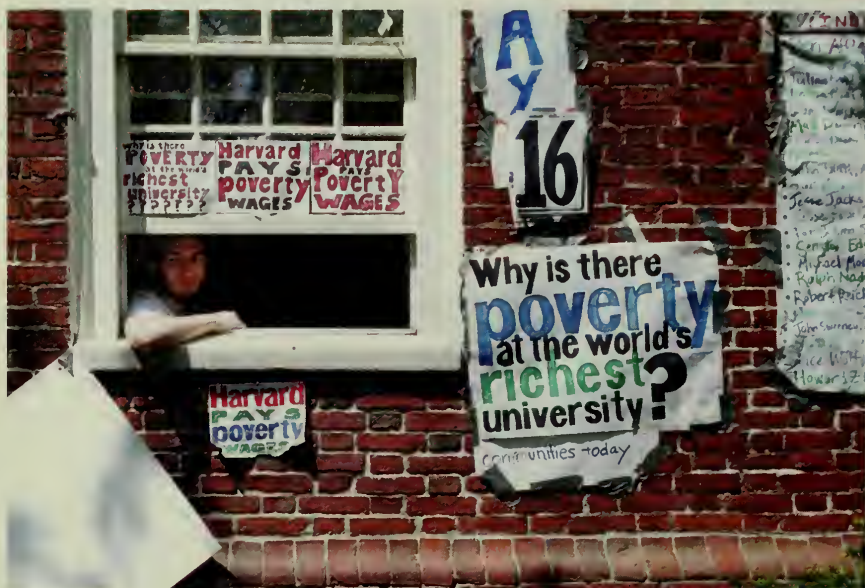
Even many of Kozlowski's fans concede people might feel more comfortable if he would just slow down so they could get a better handle on his fast-evolving empire. But after nearly a decade at the top, Kozlowski clearly relishes a pace that keeps him on the road 70% of the time. Kozlowski admits the pace helped trigger his divorce five years ago. But he still has energy to ski and fly on weekends and during the three weeks of vacation he takes each year. His favorite escape, though, is *Endeavour*. With more than 9,000 square feet of sail and a 63-foot boom, the vessel invariably draws attention as it pulls into ports from Nantucket to the Caribbean.

And there are always more deals on the horizon. Even as he was scrambling to map out his plan for CIT, he confided: "I've spent the last couple of days looking at three or four different opportunities in each of our business segments." There's no doubt he likes this market. "Things are a lot less expensive than they were a year ago," he says. So when Kozlowski is asked if it's time to slow down, he just laughs, and says: "I'm just starting to figure out this job."

With Pamela L. Moore in Greenwich, Conn.



THE EXETER HQ Kozlowski believes an elaborate office is "really unproductive"



SIT-IN AT HARVARD: Students called for more pay for janitors

LABOR

WHAT EXACTLY IS A 'LIVING WAGE'?

A grassroots movement aims to raise pay for the working poor. Here are some of the implications

Another spring, another student protest. But this time, undergrads at Harvard University won significant national attention for their cause. For three weeks starting in April, they staged a sit-in to demand that Harvard pay a "living wage" to its 1,000 or so janitors and other service workers, including those working for subcontractors. Students folded their tent city on May 8, after Harvard agreed to form a committee with student and worker representatives to look at raising pay rates that start at \$6.50 an hour. The students argued that Harvard should pay at least \$10.25, enough to lift a family of four above the federal poverty line.

Their effort cast a spotlight on a national movement to force universities, cities, and other public employers to pay a living wage. Religious, student,

and labor groups all have become involved in the cause. Here's an overview of what they're doing and why.

What is the living-wage movement?

It's a grassroots effort to help low-wage workers earn enough to support their families above the poverty line, defined in 1999 as \$17,029 a year for a family of four. This equates to \$8.19 an hour for a full-time job and is 60% higher than the \$10,700 or so a worker would earn in a year at the federal minimum wage of \$5.15 an hour.

How did the movement begin?

Religious groups and labor unions started talking about living wages in the early 1990s, which led to the passage of the federal minimum in 1998. The contemporary version dates back to 1994, when Balti-

more clergy members running food pantries noticed that many regular visitors were working full time but still couldn't feed their families. The clergy turned to the city for help. Eventually, they got an ordinance passed that requires city subcontractors to pay their employees living wage, now \$8.03 an hour.

How many of these laws are there and who do they cover?

To date, 63 living-wage ordinances have been enacted since 1994. Religious and labor groups have campaigns going in another 75 communities, while students are pushing the idea at about 22 universities. So far, most of the 63 laws passed have been in cities, though some counties, a few school boards and two universities—the University of Wisconsin and Wesleyan University—have enacted them.

Most of the laws cover companies that provide services to cities but not workers on city payrolls. Some laws apply only to a few kinds of subcontractors, such as janitorial services. Others, such as those in Detroit and Hartford, require businesses to comply if they receive tax abatements or other financial assistance. Only a handful of cities, including Durham, N.C., and Omaha, require living wages for all municipal workers.

How many workers are covered?

Only about 100,000 so far—a fraction of the working poor. Though the number

of workers earning a below-poverty wage has declined sharply in recent years, 25% of the workforce, or 30 million people, fell into this category in 1999 (chart). Many have working spouses, but only 12% of all families were in poverty.

If advocates somehow passed laws covering every city in the country that would lift the pay of roughly 1 million subcontractor employees who now earn less than the poverty rate. If the laws also covered all those workers employed directly by municipalities, it would add another 1.3 million

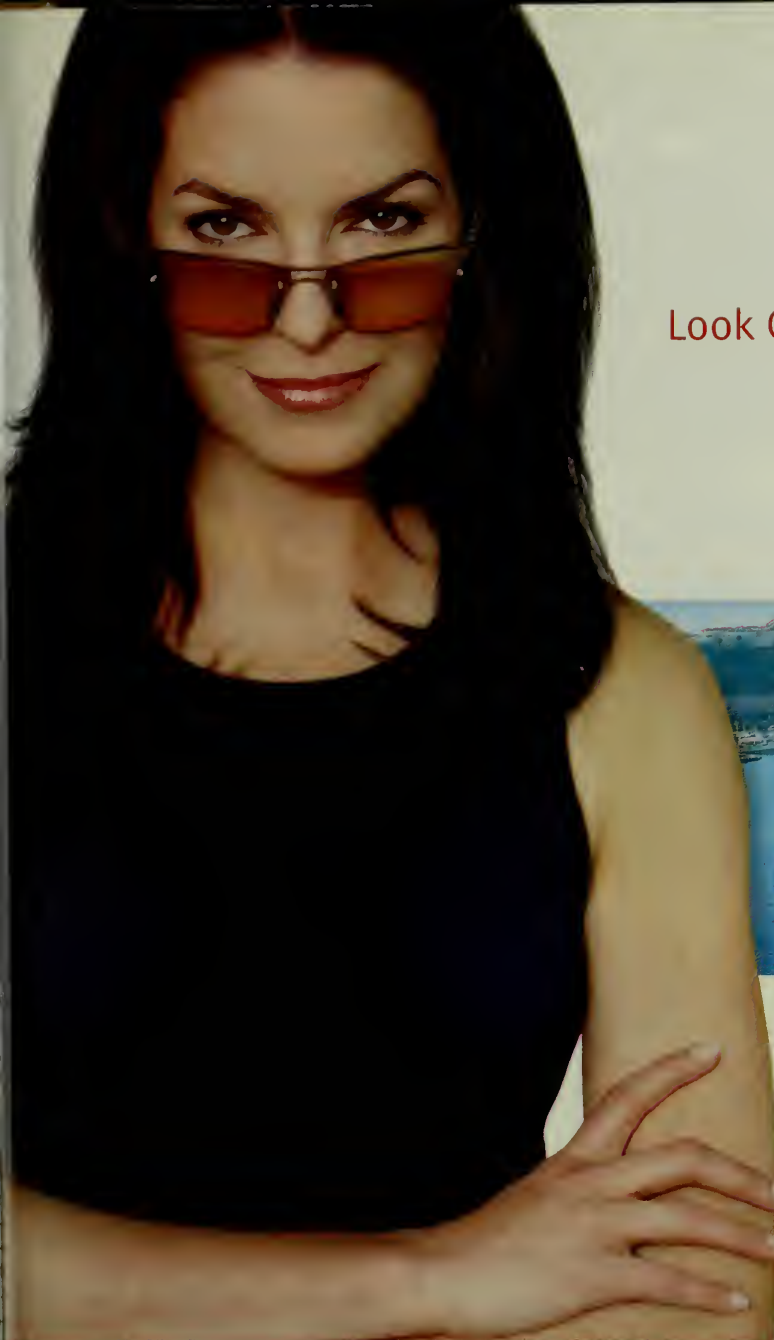
POVERTY-LEVEL WAGES: HOW WIDESPREAD?

Share of employees earning \$8.19* an hour or less in 1999

MEN	21%
WOMEN	34
WHITES	26
BLACKS	34
HISPANICS	45
15-24-YEAR-OLDS	65
25-44-YEAR-OLDS	23
45-64-YEAR-OLDS	19

*The wage a full-time worker needs to earn \$17,029 a year, the 1999 poverty level for a family of four

Data: Census Bureau, BusinessWeek



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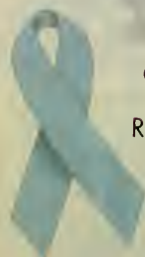
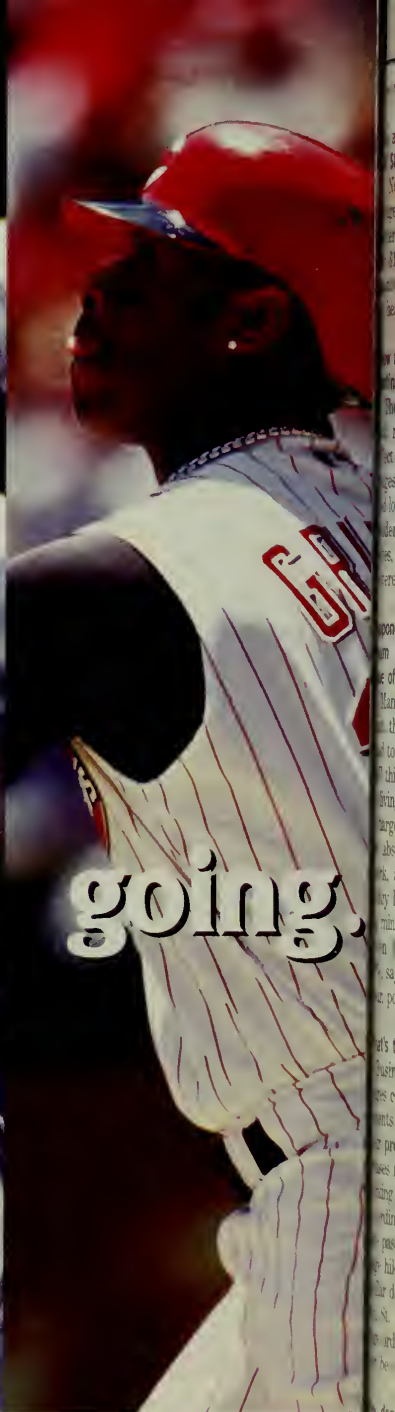
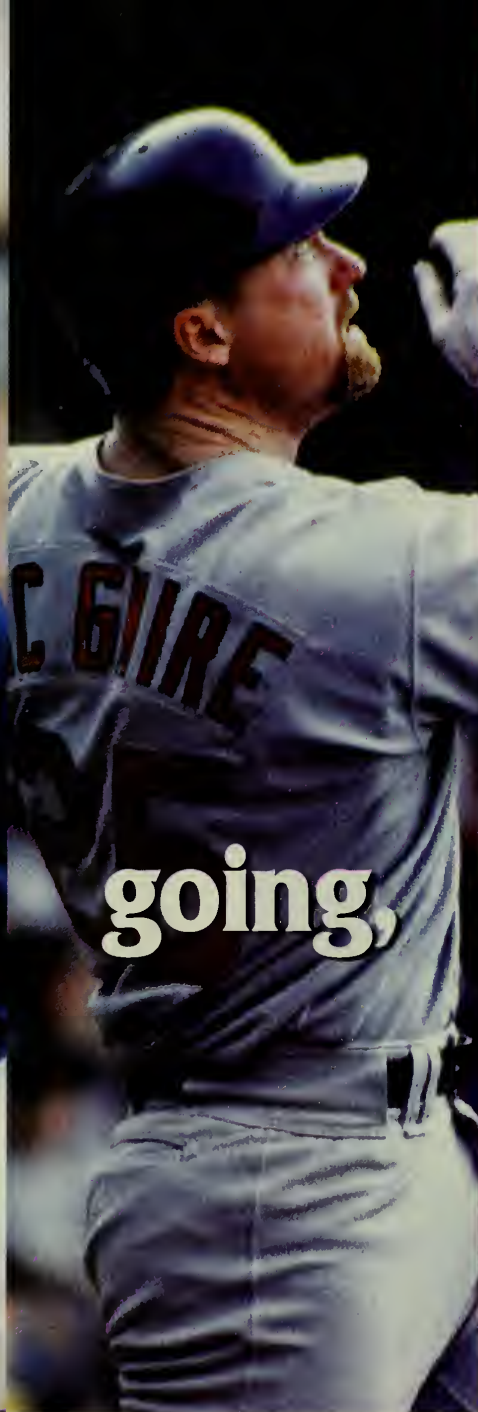
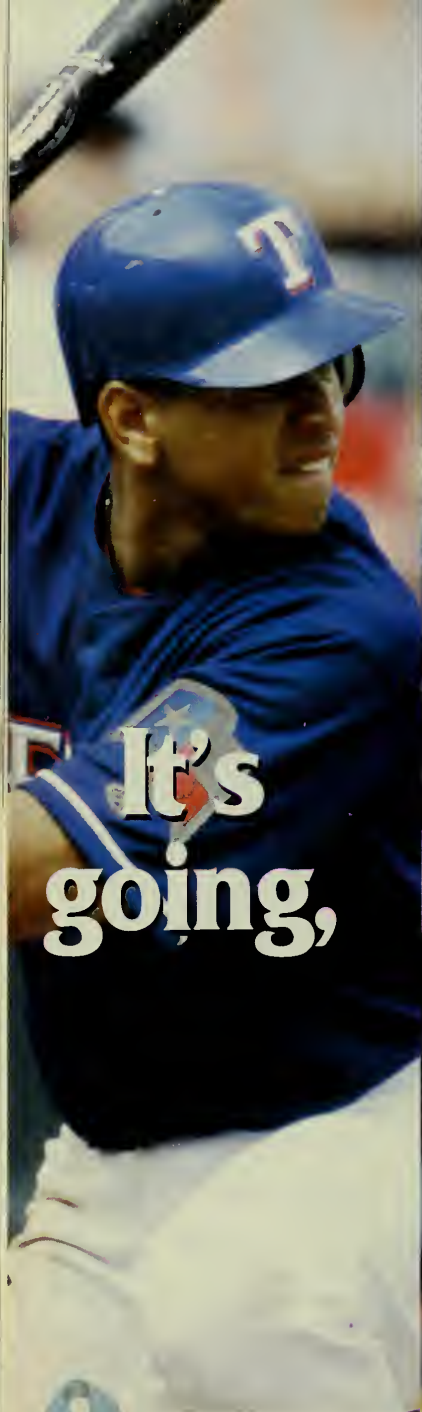


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people, for a total of 2.3 million.

Do all the laws require a minimum wage of \$8.19 an hour?

No, the amounts vary. The highest wage currently is in Santa Cruz, Calif., where it is \$12 without health benefits or \$11 with them. More than 35 ordinances require or encourage some form of health benefits.

How much does all this cost, and who's footing the bill?

The business impact has been minimal, researchers say, because the laws affect so few people and because higher wages are offset by higher productivity and lower turnover. So far, there's little evidence that living-wage laws raise taxes, although they likely would if they covered more workers.

Opponents have long argued that minimum wage laws destroy jobs. Is that the case of living-wage laws?

Many economists have backed away from the argument that minimum wages lead to fewer jobs. But even those who still think so say the logic doesn't apply to living-wage laws, because they mostly target municipal workers, so taxpayers absorb any extra costs. David Neuman, a visiting Fellow at the Public Policy Institute of California and a leading minimum-wage opponent, found that when living-wage laws raise pay by 1%, say from \$5.15 an hour to \$7.73 an hour, poverty declines by 1%.

What's the argument against such laws?

Business groups insist that higher wages could force them to cut jobs. Opponents also fear that the laws erode their profits and could spur broader increases in the minimum wage. They are working in state legislatures to make local ordinances illegal. So far, five states have passed laws banning local minimum wage hikes, and seven others have had similar debates. After Missouri passed a law, St. Louis approved its own living-wage ordinance, the legality of which will now be decided in court.

Why don't living-wage advocates push for a higher federal minimum wage, which covers most of the workforce?

Because they run into less political resistance at the local level. Business groups are more powerful in Congress, where last year they blocked attempts to raise the federal minimum to \$6.15 an hour. Washington lawmakers plan to debate similar legislation again soon, but living-wage advocates know they have no chance of getting the minimum pegged to the poverty line. So they chip away at the problem locally.

By Rochelle Sharpe in Boston

Social Issues

CITIES

IN DETROIT, THE ENGINE SPUTTERS

The Motor City's revival may be stalling in tough times



No doubt about it: Detroit these days is a city transformed. It has attracted \$18 billion in new investment since 1994, creating thousands of jobs. The crime rate has fallen to a 30-year low, banishing the Murder City tag that dates from the 1970s. Office vacancy rates are low, and real estate values have soared. Three glitzy new casinos ring the central business district, and a domed football stadium is going up alongside Comerica Park, the sparkling new home of the Detroit Tigers. Downtown, where an abandoned department store sat empty for 18 years, cranes lift steel beams into place for the new \$1.2 billion headquarters of Compuware Corp., which is moving its 6,500 office workers in from the suburbs.

But Motown's retooled engine is starting to sputter. Already, the jobless rate, which fell from 20% in 1992 to

5.4% in 1999, has shot back up to nearly 9%. As the slowing national economy threatens to stall Detroit's progress, it's becoming clear just how many obstacles remain to self-sustained growth. Public schools are still mostly failures, police

and fire services remain a mess, street lights often don't work, and taxes—roughly six times as high as in neighboring communities—still deter most businesses from moving in. While other cities grew in the 1990s, Detroit's population fell by 76,000, the 2000 Census showed, slipping below 1 million for the first time since 1920. Another blow came in April, when Mayor Dennis W. Archer, who has won credit for helping to spark

HEAVY BLOW

Mayor Archer, who helped spark the turnaround, has said he won't seek a third term

Social Issues

the city's renaissance, said he would not seek a third term.

Detroit's flashing yellow light stands as a warning to the rest of urban America. The recent economic boom turned around many decaying cities that had been all but written off. From New York's ghettos to the gritty streets of

central St. Louis, investment flooded into inner cities, jobs proliferated, and seemingly intractable poverty rates plunged. But as in Detroit, all this progress remains surprisingly fragile. Many stubborn problems remain, from lousy schools to inadequate infrastructure. Well-heeled families—including more minority ones—continue to flee to the suburbs, leaving cities with ever-smaller tax bases and swelling social burdens they can't afford to carry. If the slowdown turns into a full-blown slump, America's urban revival could grind to a halt.

FRIEND OF BILL. Detroit's tentative renewal, then, epitomizes the great strides many struggling cities have made—but huge challenges remain. In the Motor City, a chunk of the credit goes to Archer, an energetic former Michigan Supreme Court justice who took office in 1994. By reaching out to business leaders and the surrounding communities, he ended years of hostility between Detroit and its mostly white suburbs. Archer's friendship with former President Bill Clinton also helped Detroit to be selected in 1994 as one of a few cities to get federal tax



THE ARCHER LEGACY

Motown has improved markedly under its current mayor...

- Developers have pumped \$18 billion into new housing, offices, factories, and entertainment since 1994
- Crime has fallen to a 30-year low
- Property values are rising

...But will the progress continue?

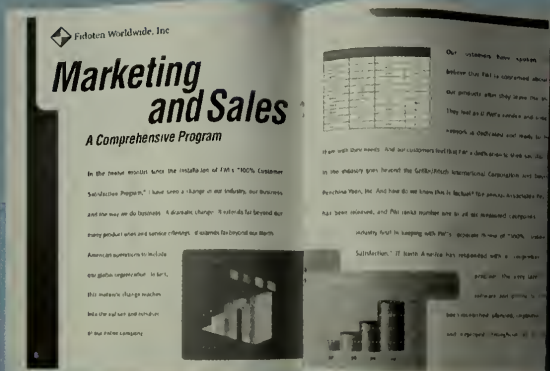
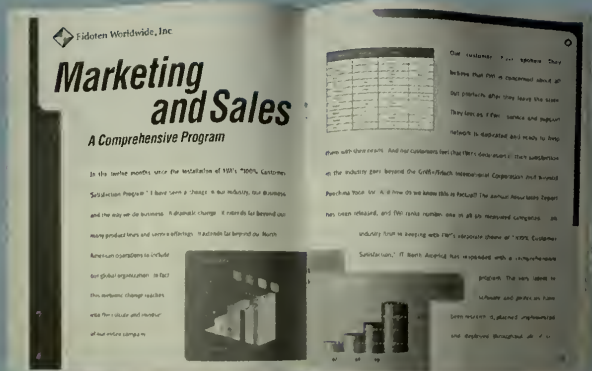
- The population is shrinking: It has fallen 7.5% since 1990
- More than 40% of residents live in poverty
- Unemployment stands at 8.6%, up from 5.4% in 1999

breaks for empowerment zones. The spurred some \$6 billion in new investment in the city's most blighted areas.

Yet Archer concedes that Detroit's growth spurt has been helped by "an enormously good economy" across the U.S. Flush with profits from record sales, Detroit carmakers and other companies have poured billions of dollars into the city. DaimlerChrysler alone spent \$2.2 billion on two new factories.

Archer has tried to ensure a permanent flow of investment and jobs by passing tax relief. Personal income taxes for city residents and nonresident workers will be rolled back by one-third, and corporate income taxes, currently at

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FY BETS

he Tigers draw in crowds, but uses to the new casino are popular



6,000 jobs and generating some \$85 million in badly needed tax revenue. Long term, the city envisioned a riverfront casino district with three larger, permanent casinos surrounded by hotels, stores, and restaurants generating \$248 million a year for the city.

But land speculators drove up riverfront property prices, Archer says, making it too expensive for the city and casino owners to assemble the necessary acreage. Now, his back-up plan is for only one riverfront casino; the others would expand their current locations.

The result will be less city tax revenue and stiffer costs for police and fire protection.

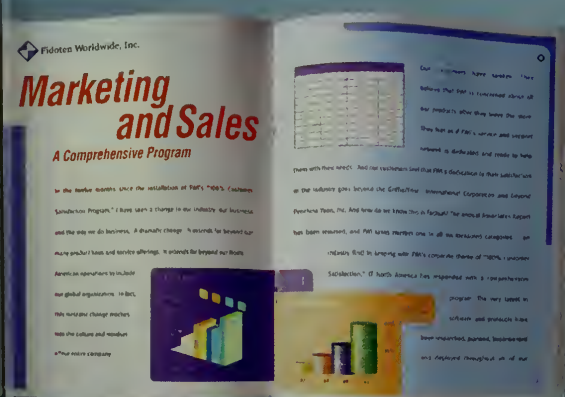
The other strategy—the two new stadiums—hasn't panned out yet, either. A handful of new restaurants and bars has popped up near Comerica Park, but the stadium has already lost its buzz. The Tigers' record is mediocre, and tickets and parking are too expensive.

sive. "The value just isn't there," gripes Jeffrey Morcom, 33, who used to attend 30 games a year and now goes to half that. Attendance is down 30% this year, to 329,489, among the lowest in baseball. Meanwhile, retailers nearby say the two stadiums are driving up rents and not bringing them enough business. "I don't know that you can link too much economic activity to what we've done," concedes Detroit Tigers CEO John McHale.

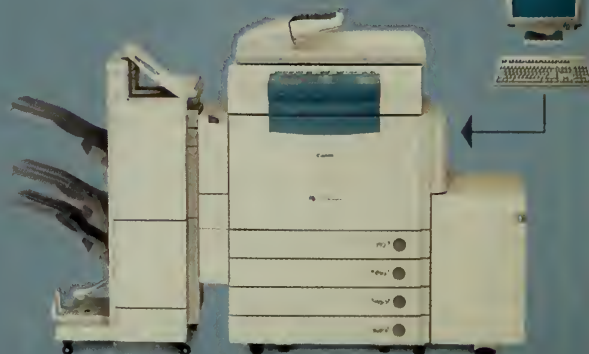
'BURBS BALK. Part of the problem is that Detroit has been unable to lure back suburbanites. It still lacks the downtown residents and workers needed to spark more development around the stadiums. "If there's going to be an economic recovery in Detroit, it will be because large firms commit to move downtown and hire people," says Mark S. Rosentraub, urban affairs dean at Cleveland State University.

Detroit has staged a remarkable recovery, given the depths to which it had fallen. But now, as the carmakers slow down, so, too, does the city. Archer's glitzy showpieces aren't enough to support the city's long-term health on their own. If his successor can't come up with an encore, Detroit may find its progress stalled.

By Joann Muller, Jeff Green, and David Welch in Detroit



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ENVIRONMENT

COAL GETS CLEANER—AND BETTER CONNECTED

Fresh technology and a pal in the White House give it new respectability



East of Tampa in rural Polk County, Fla., there's a \$300 million state-of-the-art power plant that serves as Exhibit A in the case for "clean-coal" technology. The plant combines two technologies never brought together before. In the first, coal is converted into a cleaner, synthetic gas. Next, the heat is recycled. Put together, the technologies make Polk's generators up to 12% more efficient than last-generation plants. And that means more power from less coal. All told, this 250-megawatt showcase plant emits significantly less sulfur dioxide, nitrogen oxides, and other pollutants than conventional coal plants.

Engineers have spent billions of dollars of government and industry money over the past decade to develop such clean-coal technologies. These methods, they say, will allow coal—which now provides slightly more than half of the nation's electricity—to continue to play an important role in U.S. power generation without unduly polluting the environment.

Environmentalists and other critics shudder at the very mention of "clean" coal, arguing that it can never be made acceptable from an environmental standpoint. Extracting coal from the ground is a messy, polluting process. And burning it, in no matter what form, always re-

leases carbon dioxide, a greenhouse gas. "The term 'clean coal' is a myth, a very cynical term," says Lexi Schultz, a lawyer at the U.S. Public Interest Research Group. The advocates' goal, she says, "is to increase the use of coal, period."

That criticism isn't likely to go far in Washington, however. Clean coal's advocates have a powerful friend in President George W. Bush, who was the No. 1 recipient of coal-industry campaign contributions, according to the nonpartisan Center for Responsive Politics. Environmentalists say that his ties to the coal industry partly explain his February decision to withdraw U.S. support from the Kyoto Protocol, the international agreement to curb global warming by restricting carbon dioxide emissions from the burning of coal and other fossil fuels.

The Administration is also considering requests from the coal and utility industries to drop Clinton Administration-initiated lawsuits that would require new pollution controls to be installed on old coal-fired power plants. And Bush has shown no enthusiasm for a Senate bill that seeks to tighten restrictions on coal plant

CLEAR NIGHT: By using less coal, the Polk power plant pollutes less

emissions and require older power plants to meet stringent Clean Air Act standards. Instead, the President has incorporated into his budget proposal \$2 billion in federal funding to promote clean-coal technology.

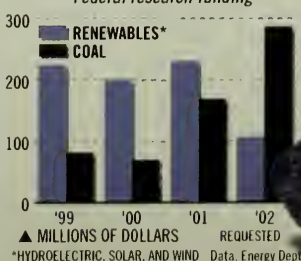
MORE EFFICIENT. Tampa Electric's Polk Power Station relies on some of the latest advances in a field of research that began in the 1980s, when coal plants were shown to contribute to acid rain. In 1990, Congress amended the Clean Air Act, phasing in tighter limits on emissions of soot particles, nitrogen oxides and sulfur dioxide from power plants. To help implement those limits, the Energy Dept. has since spent \$1.8 billion on 39 clean-coal technology programs, while

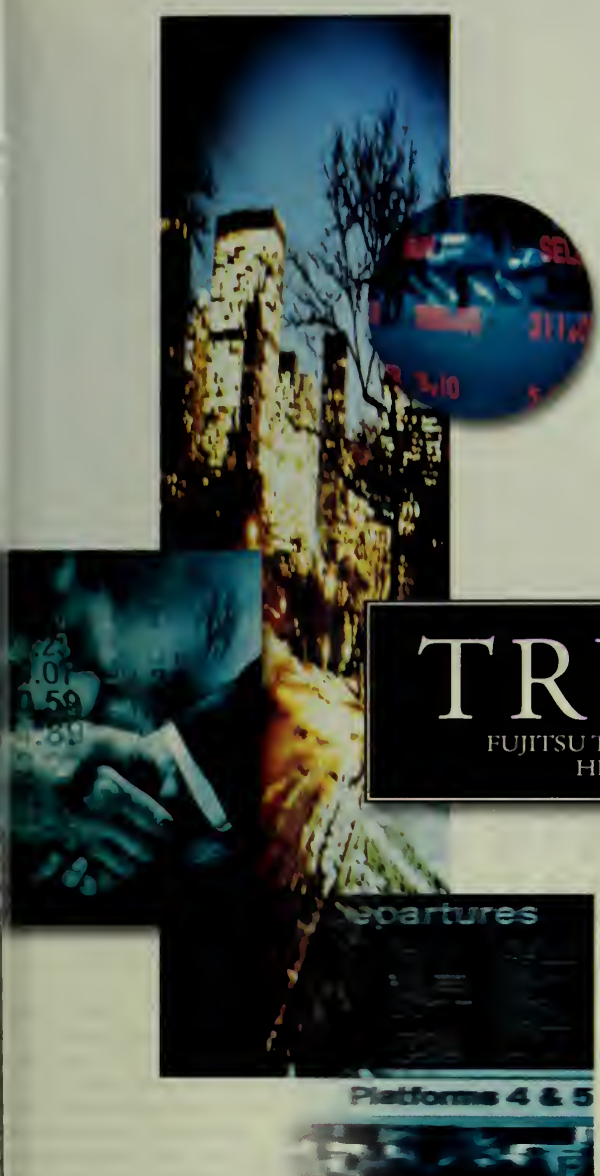
state governments and the coal industry kicked in further \$3.4 billion.

Several of the resulting technologies are already in widespread use. They include new equipment that cleans coal after it is mined, new methods for burning coal, and advanced techniques in treating gas

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es after burning. This so-called reburn technology splits the burn into two stages for more complete combustion, which results in lower emissions of nitrogen oxides. The technology has already been adopted by three-quarters of the nation's coal-fired plants. Meanwhile, improvements in antipollution "scrubbers," designed to treat exhaust from smokestacks, have reduced emissions of sulfur dioxide by 95% or more.

In recent years, much of the research has focused on the development of more efficient burning methods so that more electricity can be extracted from less coal. An average pound of coal contains about 10,000 BTUs. Existing coal-fired plants capture only 33% to 35% of that. The rest is wasted. But plants built in the past five years, such as the one in Polk County, can extend that slightly, extracting 37% of the energy from a pound of coal. And those being built now, using the Polk plant combustion technology or a similar method, are expected to have efficiencies of about 40%.

LITTLE TO FEAR. In the future, clean-coal enthusiasts anticipate even more dramatic strides in efficiency and environmental quality. An Energy Dept. projection for coal sets an efficiency goal of 60% by 2025. On the environmental front, the trick, says Thomas A. Sarkus, senior engineer at Energy's National Energy Technology Laboratory, is balancing environmental measures with affordability. "It's not a technical matter," he says. "The more controls you want, the more it's going to cost."

The coal industry fears those higher costs. They could eliminate coal's biggest selling point—that it's cheaper than natural gas—thus forcing utilities to switch to other fuels, including gas. But so far, such a shift seems unlikely. "What's the alternative to coal?" asks Ronald H. Carty, director of the Illinois Clean Coal Institute. "If you're talking renewables, I don't know how you do it."

In fact, coal executives have little to fear from alternative energy. While coal provides more than 50% of the nation's electricity, alternative sources, such as solar and wind power, provide less than 3%. The percentage of BTUs generated from coal is expected to drop slightly in the next 20 years, says Sarkus, but demand for power will grow so much that coal usage, in tonnage, will jump 30%. Technologies such as those used in the Polk County plant in Florida are the only way to avoid the potentially harmful environmental consequences of that surge in coal use. Clean coal is clearly here to stay.

By Patrick A. McGuire



OIL

THE ARCTIC ISN'T THE ONLY FLASH POINT

Where the drilling debate could get hot in the Lower 48



Along a 149-mile stretch of the Missouri River in northern Montana sits the Upper Missouri River Breaks, a national monument of majestic proportions. Its more than 300,000 acres—some filled with sagebrush and multicolored cliffs—have changed little since Lewis and Clark mapped the river's length in the early 1800s as they explored the West for President Thomas Jefferson.

But like Alaska's Arctic National Wildlife Refuge (ANWR), the Upper Missouri Breaks is noteworthy for more than its beauty: It's a good place to drill for oil. That means it could become the next ground zero in the fight over President Bush's comprehensive energy plan.

That blueprint, scheduled to be unveiled on May 17, will ask Congress to open ANWR to oil and gas exploration. It also would relax federal and state environmental rules to make it easier to build oil refineries, pipelines, and elec-

tricity-generating plants. Federal agencies would be granted the power of eminent domain to speed the building of more power transmission lines. The government would ease rules to help utilities upgrade and renew licenses for nuclear power plants. And consumers would be able to claim tax credits for buying energy-efficient autos and appliances.

Still, the top priority of Bush and his Capitol Hill allies is to dramatically increase domestic supplies of oil and gas. And since lands under the Interior Dept. protection now produce 28% of the U.S. energy supply, one way Bush can decrease dependence on foreign oil is to increase exploration on federal land.

RICH POOLS. That, at least, is the fear of environmentalists who believe Bush soon will open up some national forests and monuments—especially those designated as such in the closing days of the Clinton Administration—for drilling and mining. Mark D. Pfeiffer, spokesman for Interior Secretary Gale Norton, denies there are any cu-



Westerners may treasure places like Colorado's White River, but they also would welcome the jobs that oil rigs would bring

ANWR drilling, environmental groups, including the Wilderness Society and the Natural Resources Defense Council, are hoping to change that. "We're giving this the full-court press," says Daniel Becker, director of the Sierra Club's global warming and energy program. "We beat the President's father when he tried to do this, and we're going to beat this President, too."

Truth be told, the proposal for drilling in ANWR, which lacks support on Capitol Hill, is probably already dead. Christine Todd Whitman, administrator of the Environmental Protection Agency, conceded as much in late April, although her press aide quickly issued a correction claiming that Whitman misspoke.

BRAINSTORMING. That leaves the lower 48 states, where the battle has yet to be joined. In the last year of his tenure, Clinton designated 19 sites, or some 3 million acres of land, as national monuments. The Upper Missouri Breaks, for example, was set aside on Jan. 17—three days before Clinton left office. Now, Interior's Norton has begun the process of writing land-use management plans for each new monument. Norton is inviting numerous parties—not just environmental groups—to help develop the plans, which conceivably could in-

al Monument, a 1 million-acre expanse of deep canyons adjacent to the most famous federal land of all: Grand Canyon National Park.

Most voters in Rocky Mountain states strongly support the economic development that drilling would bring to faltering local economies. Says Representative Barbara Cubin (R-Wyo.), a longtime friend of Cheney who is advising the White House energy task force: "Natural gas from my state, be it in the Green River Basin or the Powder River Basin, is just waiting to be drilled and sent to market."

But even if Democrats and their green allies are able to block drilling in Clinton-designated monuments, they're likely to have a tougher time stopping exploration on the millions of acres of federally managed lands already available to energy companies. Since the '70s, industry groups claim, the feds and the states have used reams of regulations to tie up much of the land.

"The greatest impediment to securing our nation's natural-gas resources for energy generation is our own federal government," says Robert W. Fisher, an executive at Ballard Petroleum, a Billings (Mont.) independent explorer, and president of the Montana Petroleum Assn.

The Administration appears ready to agree. Officials already are moving to streamline the permit process and to push more regulations to the state level.

If the White House gets its way, Bush will wind up being "the most anti-environmental President in modern times," says Rodger Schlickeisen, president of Defenders of Wildlife, a nonprofit conservation group. "This is an Administration that has in-

credible ties to the oil and gas industry—they've been salivating over the prospect of getting into our public lands for some time." But with Bush's plan winning kudos from the oil patch, GOP lawmakers, and consumers frustrated by the big bite that energy prices are taking out of their budgets, Schlickeisen and his friends have a steep hill to hike.

By Laura Cohn in Washington

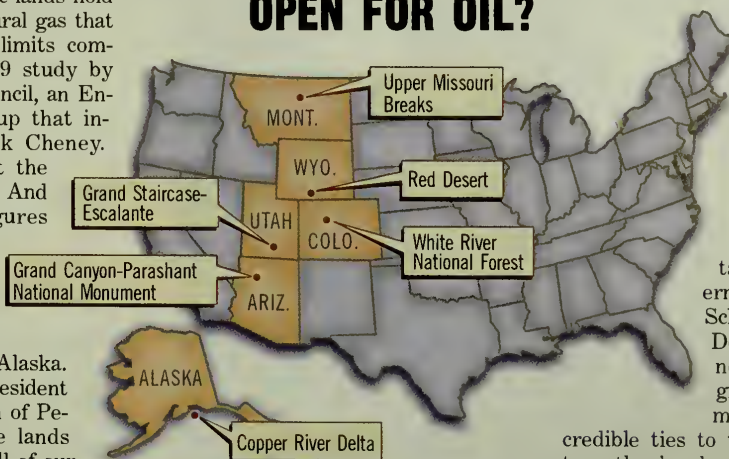
it plans to drill on federal lands beyond ANWR. But, he adds, "we want to protect lands and use them so they remain intact for generations to come." Areas thought to contain oil, gas, and coal deposits include Colorado's White River National Forest, Utah's Grand Staircase-Escalante, the Copper River Delta on the Gulf of Alaska, and Wyoming's Red Desert. In the Rocky Mountain states alone, public lands hold 1 trillion cubic feet of natural gas that is either restricted or off limits completely, according to a 1999 study by the National Petroleum Council, an Energy Dept.-designated group that included Vice-President Dick Cheney. That's enough gas to meet the nation's needs for six years. And according to the latest figures from the U.S. Geological Survey, the continental U.S. holds some 22 billion barrels of oil—more than twice the amount the agency says is available in Alaska. Says Marlan W. Downey, president of the American Association of Petroleum Geologists: "These lands were established to serve all of our nation's citizens, not to provide scenic views for tourists."

So does this mean that oil rigs will no longer appear among the ancient cottonwood groves of the Upper Missouri River Breaks? Not exactly. While the area mostly escaped the notice of Democratic lawmakers gearing up to block

drilling. "We want to listen to the ideas and concerns of everyone, whether it's the local Sierra Club or the local Chamber of Commerce," says Pfeifle.

That's ringing alarm bells among environmentalists, who are particularly worried about Grand Canyon-Parashant National

OPEN FOR OIL?





Biotechnology
researchers call it
"golden" rice.

For the color.
For the opportunity.

*"When mothers and their children eat
an adequate amount of vitamin A in
a daily meal, it could help alleviate
more suffering and illness than any
single medicine has done."*

The excitement expressed by plant
biologist Charles Arntzen reflects the
golden opportunity that many see in a
new strain of rice being developed with
biotechnology. "Golden" rice contains
increased amounts of beta-carotene, a
source of vitamin A. Because rice is a crop
eaten by almost half the world, golden
rice could help relieve a global vitamin
deficiency that now causes blindness and
infection in millions of the world's children.

Discoveries in biotechnology, from
medicine to agriculture, are helping
doctors treat our sick, farmers protect our
crops—and could help mothers nourish
our children, and keep them healthier.
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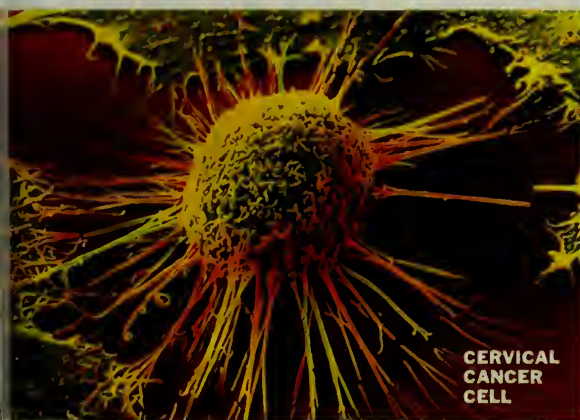
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Developments to Watch

BY CATHERINE ARNST

ISPATCHES FROM THE WAR ON CANCER

Cancer treatment is about to undergo a sea change, bringing new drugs that precisely target the causes of tumor growth. In five or six years, patients may no longer be told they have something called lung or breast cancer, predicts Dr. Larry Norton of Memorial Sloan-Kettering Cancer Center, one of the world's leading researchers. Instead, a cancer will be defined by the cellular mechanism that causes it, and therapy will be tailored to that mechanism—much the way an infection is treated. Drugs will home in on the agents of disease without harming healthy tissue. "What we are seeing today could be the beginning of the end of chemotherapy," Norton told BusinessWeek at the annual meeting of the American Society of Clinical Oncology in San Francisco, May 12-15. Although many of the clinical trial results discussed at the meeting are still in very early phases, the excitement among the 25,000 attendees is palpable. Senior writer Arnst reports:



LISTING ANTIBODIES THE BATTLE

WOUNDS CAN BE DEADLY, BUT because they are homegrown, they fool the body's defense mechanisms. Several labs are trying to goose the immune system into attacking cancer cells through the use of vaccines. One that has attracted attention is the GVAX vaccine from Cell Genesys of Foster City, Calif. To immunize a patient, doctors participating in Cell Genesys' trial remove viable tumor cells and genetically engineer them to secrete a hormone called GM-CSF, which plays a key role in regulating the body's immune response. Doctors then reintroduce the cells into the patient. In an early-phase clinical trial of 80 patients with lung

cancer, 11 have completed the GVAX therapy. Of those, three with advanced, untreatable cancer went into remission. In another three with early-stage cancer, the tumors stopped growing. "GVAX has produced one of the most dramatic responses I have seen with an experimental agent," says lead investigator Dr. John Nemunaitis of US Oncology in Dallas.

Therion Biologics of Cambridge, Mass., takes a different approach. It employs a neutralized pox virus, known to stimulate immune-system responses, combined with a protein found on the surface of tumor cells. In a trial of nine patients with a range of late-stage cancers—patients whose usual life expectancy is less than one year—five were still alive after two years.



IN THE LAB: ImClone's goal is to block "receptors"

CHEMO WITHOUT THE SIDE EFFECTS

SOME EXPERIMENTAL CANCER drugs target an enzyme called the epidermal growth factor. It triggers cell growth and division—and it is found in more than 50% of all cancers. In healthy people, EGF is in scarce supply. But in the early 1980s, researchers discovered that it is expressed at very high levels in cancer patients with advanced disease, most likely churned out by cancer-related genes. The goal with EGF drugs is to block the "receptor" for the enzyme on the

surface of cancer cells. (Receptors are docking areas on cells that bind with proteins in the bloodstream.)

The most advanced EGF-blocking drug is ImClone Systems' IMC-C225, which is under accelerated review at the Food & Drug Administration. Dr. Leonard Saltz of Sloan-Kettering reported significant tumor shrinkage in 27 of 120 patients with widespread colorectal cancer who didn't respond to other treatments. That 22.5% response rate is considered very high in a trial with such sick patients. Plus, the disease was completely stabilized in another nine patients. The main side effect, as with most other EGF blocking agents, was an acne-like skin rash—a minor discomfort compared with the side effects of existing chemotherapies. ImClone, based in New York, is also testing IMC-C225 in pancreatic, head, neck, and lung cancers, and says it expects to file for FDA approval in June.

Taking Aim at Cancer

Experimental drugs that attack the tumor, not the patient

DRUG	TARGET	STATUS
IMC-C225 ImClone Systems	Blocks the epidermal growth factor receptor, found in more than half of all cancer types	Phase II/III trials for colorectal, pancreatic, head and neck, and non-small-cell lung cancers. The FDA has granted fast-track approval status
GVAX Cell Genesys	A vaccine that trains the patient's immune system to attack tumor cells	Phase I/II trials for non-small-cell lung cancer, prostate, pancreatic, and myeloma cancers
ABT-627 Abbott Laboratories	Blocks the endothelin-A receptor, which aids the cancer	Phase II/III trials for advanced prostate cancer
SU5416 Pharmacia	Blocks growth-factor signals sent by tumors to stimulate blood vessel growth, which allows them to spread	Phase III trials for colorectal cancer, Phase II trials for a number of solid tumors, including breast cancer

CORPORATE AMERICA'S BIG DEBT TO THE FED

Rate cuts have sparked a massive burst of borrowing

If you want evidence of the Federal Reserve's power to arrest an economic slowdown, look no further than the corporate bond market. The Fed's rate cuts have allowed corporations to begin repairing their balance sheets, cutting their borrowing costs, and raising funds for expansion.

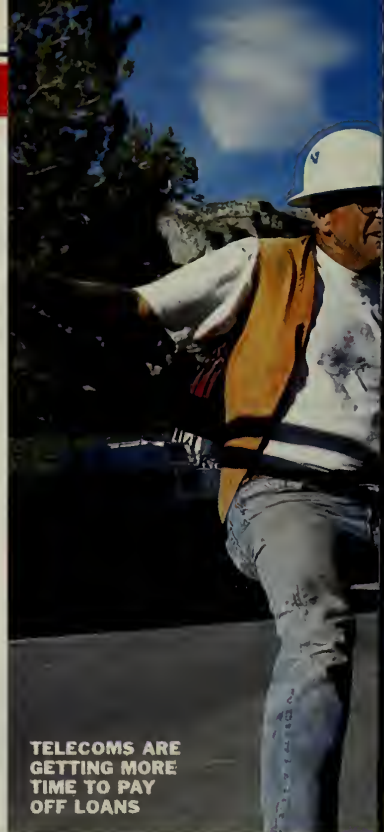
Corporations are borrowing on a massive scale. They have sold more than \$291 billion of bonds in the U.S. so far this year, compared with \$187 billion at this time last year, according to Thomson Financial Securities Data. Excluding junk bonds, which were still strong in early 2000 in the last days of the stock market boom, the turnaround is even more dramatic: \$212 billion this year vs. \$63 billion last year, according to Merrill Lynch & Co. At this rate, the market will have bought as much investment-grade debt by July as it did in all of 2000, a record year itself.

The corporate-debt market was comatose before Fed Chairman Alan Greenspan and fellow governors made the first of five half-point rate cuts on Jan. 3. Now the market is stronger than ever. "Nobody would have foreseen this, even considering the benefit of Mr. Greenspan," says Peter Milhaupt, a managing director and co-head of Cred-

it Suisse First Boston's U.S. debt-underwriting section. Investors swallowed \$40 billion of new corporate bonds in the first two weeks of May with barely a burp. Amid the offerings, interest-yield spreads over Treasuries increased only 0.05 percentage points. "It is amazing. There's been very little indignation," says Mary Rooney, a bond strategist at Merrill.

BIG DROP. The market revival is a boon to business. For one, companies are reducing their interest expense. Market interest rates on 10-year, single-A debt are generally down about 100 basis points, to 6.5% from last year, says Dennis Adler, a bond strategist at Salomon Smith Barney Holdings Inc. More important, about half of the new debt is being used to pay off commercial paper, which matures every few weeks. That makes companies less vulnerable to sudden problems in the commercial paper market, like the ones that hit when California utilities faltered. By extending the debt a few years, companies lock in time to deal with problems in their own business. They build in the kind of cushion Lucent Technologies Inc. craved earlier this year when it was scrambling to replace its commercial paper and avoid a liquidity crunch.

In a dramatic illustration of how this exceptional market is working, WorldCom Inc. sold \$11.8 billion of debt on



TELECOMS ARE GETTING MORE TIME TO PAY OFF LOANS

May 9. The offering was the biggest ever by a U.S.-based corporation and echoed giant issues earlier this year by France Télécom and AT&T Wireless. Larger issues are selling best because institutional investors believe the bonds will be easier to trade if the market falters. WorldCom originally expected to sell about \$7 billion of debt now at \$5 billion more later, but found the market strong enough to fund all of its needs right now.

Half of WorldCom's proceeds are going to pay off its commercial paper. The paper is rated "second-tier" for credit worthiness and that makes it vulnerable to being suddenly spurned by lenders. An additional fourth of WorldCom's proceeds are going to pay down existing debt. Only one-fourth will be invested



HIGH RISK? Lenders are willing

WHY BANKS STILL LOVE HOMEBUILDERS

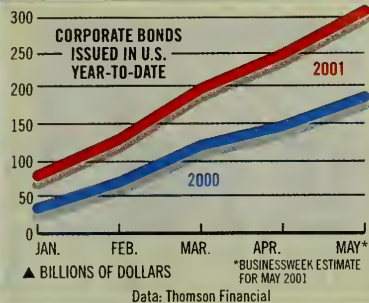
The housing market, blissfully unaffected by the economic slowdown, continues to be blessed by Federal Reserve interest rate cuts. First, the banks that lend to homebuilders are opening their pocketbooks wider than ever. And low mortgage rates are attracting new buyers to the market, who

would not have considered buying six months ago.

The banks are willing to take on business because the Fed has moved to widen their profit margins. Banks' short-term funds and lend long. Because the Fed has dramatically cut short rates, while long-term rates have remained comparatively stable, banks are trying to push out as many mortgage construction loans as they can. On top of that, sure of how generous the banks have become, the Federal Deposit Insurance Corp.'s May 9 survey of 1,800 banks



BOND BOOM



THE BIG EIGHT

ISSUER	DATE	AMOUNT BILLIONS
FRANCE TELECOM	3/7/01	\$16.4
WORLOCOM	5/9/01	11.8
DAIMLERCHRYSLER	1/11/01	6.6
AT&T WIRELESS	3/1/01	6.5
MORGAN STANLEY	4/18/01	6.0
VERIZON COMMUNICATIONS	5/9/01	5.4
FORD MOTOR CREDIT	4/10/01	5.0
KELLOGG	3/23/01	4.6

* Issues sold in U.S. markets

Data: Thomson Financial

WorldCom's business. The mix is typical of how new issues are being used and suggests the market is not funding a new round of reckless capital spending. "Companies are basically doing this to clean up their balance sheets," says Richard J. Peterson, a strategist who backs deals at Thomson Financial. In fact, much of the commercial paper being refinanced in the bond market was originally issued to pay for past telecom capital spending, such as burying fiber-optic cables and building wireless networks. Now telecoms are getting over time to pay.

Other industries are also taking advantage of the market. Recent issuers include DaimlerChrysler, Morgan Stanley, Ford, Kellogg, Viacom, CIT Group, and Caterpillar. Navistar International

Corp. and Target Corp. are expected to come to market soon.

Is the money to buy the new issues coming out of the stock market? Not much. Most is coming from interest payments and from the federal government's retirement of Treasury debt. A big reason bond investors are buying the issues is that they've become more confident the Fed rate cuts will keep the economy out of recession. "They're spurring people's appetites to take credit risk," says John Bender, portfolio manager of the Strong Corporate Bond Fund. Two institutional investors recently changed their investment strategies and bought a combined 15% of DaimlerChrysler's \$2 billion issue in early May, says Milhaupt of CSFB, one of the underwriters. The investments re-

flect new confidence in the cyclical auto industry and the belief that yields on corporate bonds are worth the risk.

Bender bought new WorldCom bonds for their yield. The 30-year debt, rated BBB+, was priced to yield 2.65 points over Treasuries, or 8.42%. That's nearly 1 point higher than comparable debt for AOL Time Warner Inc. and Occidental Petroleum Corp., he says. Sure, the telecom industry has more trouble than media and energy, but "we're getting paid more than enough extra income for the risk," says Bender.

FEW MERGERS. It is unlikely the bond market will stay so hectic, even after the Fed's May 15 half-point cut in interest rates. The amount of "second-tier" commercial paper outstanding has been cut by about one-third already, according to Salomon Smith Barney. Corporations probably won't want to reduce it too much more. Unlike when the Fed was starting to cut short-term rates, borrowing with commercial paper is again becoming significantly cheaper than borrowing long-term. Nor, will as many new bonds be needed to finance mergers: M&A volume is half what it was this time last year, says Peterson. Salomon's Adler expects the torrid pace of new bond issues to slow by one-third in coming months.

But even if it does, 2001 will be a record year in the corporate bond market. Chairman Greenspan, take a bow.

By David Henry in New York

practices. The number of banks that make risky construction loans edged 12% in the six months ended March, to nearly one-third of all banks, the survey. The loans are risky because they're made to finance homes built before finding a buyer, or for 100% of a property's value. Banks haven't slowed a tic since the March. "There's been no letup," says Josef Poncik, co-owner of Poncik Construction Inc., a Richmond (Tex.)

In fact, Poncik says he's got capital to work with. "We've start-

ed a few more houses than normal."

Are banks getting ahead of themselves by making more risky loans? Some bankers, including Richard Robertson, president for community development at European American Bank, think some lenders are being too aggressive. But with the spread between long- and short-term rates widening after each Fed cut, the banks can afford to take on more risk. And if the Fed policy turns around the economy, the banks really will be golden.

By Heather Timmons in New York

DID THE SEC DROP THE BALL?

Angry investors wonder how Reed Slatkin stayed in business

The first inkling of trouble for many investors came with an invitation to a meeting at a Santa Monica (Calif.) law office on Apr. 30. As attorneys Richard M. Pachulski and Brian A. Sun explained it, the money manager they represented—one whom many of the attendees had trusted with their life's savings—was declaring bankruptcy. "There was substantial shock in the room," says one investor present at the

meeting, who asked that his name not be used. "I remember thinking: 'How the hell did we get to this point?'"

How indeed? The saga is still unfolding, but right now, money manager Reed E. Slatkin, a 52-year-old Internet millionaire with blue-chip connections in Silicon Valley and Hollywood, stands accused of defrauding more than 500 investors of hundreds of millions of dollars. On May 11, agents of the FBI and

the Internal Revenue Service raided Slatkin's home office in the resort city of Santa Barbara, north of Los Angeles.

On the same day, the Securities & Exchange Commission obtained a court order freezing Slatkin's assets and filed a suit charging him with operating an unregistered investment business and lying to the government about accounts he said he held in Switzerland. The SEC said Slatkin was operating a Ponzi scheme—collecting funds from new investors to pay off earlier investors—to finance a lifestyle that afforded him two country club memberships, a private jet, and a reputation as a philanthropist **SCIENTOLOGIST**. Beyond the shock of Slatkin's bankruptcy, some investors were also surprised to find out that the SEC had been investigating Slatkin since as early as 1997. Yet it was private lawsuits that brought Slatkin's problems to public light. "A number of investors will be asking hard questions about whether the government did its job," says Richard S. Conn, a Los Angeles attorney representing a retired venture capitalist who claims to have lost \$15 million through Slatkin. Says Kelly C. Bowers, the SEC's assistant regional manager in Los Angeles who supervised the case: "Slatkin repeatedly lied to the staff, produced false documents, and obstructed our investigation." Slatkin has not responded publicly to any of these charges, nor did he return phone calls from *BusinessWeek*. His attorney, Sun, says his client has no comment.

"The SEC had an ongoing investigation. I don't believe they were fully aware of everything until it started to become public," says Los Angeles attorney Richard L. Wynne, who represents Slatkin's creditors. "My clients would have preferred SEC action a long time ago, preferably before they invested. Everybody was thinking that somebody else did the due diligence."

By all accounts, Slatkin is an exceptionally persuasive individual. A native of Michigan, he became involved at a young age with the Church of Scientology, a religion based on the writings of the late L. Ron Hubbard. Slatkin and his wife, Mary Jo, made a living in the 1970s and early 1980s as ministers for the church, according to testimony Slatkin gave the SEC last year. In the mid-1980s, Slatkin said, he began investing money in the stock market both for his own account and as a favor to friends, many of whom were Scientologists. Nobody knows how much, but some believe that because of Slatkin's connections, the investments by the SEC



THE SEC ALLEGES THAT SLATKIN:

- Operated a Ponzi scheme in which he collected new funds from investors to pay off earlier investors and finance his lavish lifestyle

- Misappropriated several hundred million dollars from as many as 500 investors

- Told authorities he was returning investors' money while he was raising tens of millions more

- Violated federal securities law as an unregistered investment adviser

- Lied to authorities, saying investors' money was in Zurich-based trading accounts that don't exist

Data: Securities & Exchange Commission

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MOVING IN On May 11, the FBI and the IRS raided Slatkin's office in Santa Barbara, Calif.

entologists may have accounted for the bulk of the money he was managing.

Slatkin hit the big time in the late 1990s after investing \$75,000 to co-found EarthLink Inc., now the second-largest Internet access provider in the U.S. A director of the company until his resignation in late April, Slatkin held a stake that at its high point in 1999 was worth more than \$100 million. That big position in a publicly traded company enhanced Slatkin's credibility, many investors say. "The EarthLink position was legitimate and publicly verifiable," says Stuart W. Stedman, a wealthy Texan whose family invested \$34 million with Slatkin. EarthLink Chairman Sky D. Dayton and CEO Charles G. Betty personally invested funds with Slatkin. Both declined to comment.

TINSELTOWN, TOO.

Slatkin also gained entrée into the inner circles of Hollywood. As first reported by the *Los Angeles Times*, actor Giovanni Ribisi, who played an ethically challenged stockbroker in the film *Boiler Room*, was an investor. So was *Air Force One* producer Arny Bernstein, who got Arnold Schwarzenegger and Kevin Costner to appear in a video for Slatkin's 50th birthday. Bernstein says neither Schwarzenegger nor Costner knows Slatkin and that a friend and fellow investor asked him to make the video.

Slatkin's defense, in rambling and often contradictory depositions, is that he

was managing money for "friends." He claims to have turned his own negative net worth in 1983 into a \$25 million personal fortune five years later via newly acquired investing skills. "My purpose is to help the Scientologists who have their attention away from money," Slatkin told the SEC. "It was never intended to be a business." He told the SEC that he wasn't getting paid fees but that some clients had contracts with him giving him discretion to invest where he "deemed appropriate."

Three lawsuits and a petition in federal bankruptcy court from investors tell a different story. Former clients say he expected compensation of 5% to 20% of the profits. In one suit, investor Arthur Berke says he signed an agreement promising Slatkin 20% of his portfolio's profits. In 1996, Berke met Slatkin through his son-in-law, an accountant who worked with Slatkin. Slatkin told Berke to expect short-term returns of 22%. Although he received three checks written by Slatkin, all of them bounced in mid-March. Berke's lawsuit says he has lost more than \$1 million.

The SEC's investigation heated up in December, 1999, when the agency subpoenaed documents from Slatkin. The following January and February, the agency took more than 500 pages of depositions from Slatkin and his bookkeeper. At issue: whether Slatkin violated federal securities law by accepting fees

for managing money without registering as an investment adviser. For more than a year, Slatkin maintained that he did not accept fees and that he was liquidating the accounts of all of his "friends." Some investors did get money back. The SEC reports that a net \$46.1 million was returned to clients, but that represents only 20% of the \$230 million that Slatkin admits he had under management. According to the lawsuits, however, Slatkin continued to raise tens of millions of dollars throughout this time. Lawyers and investors say that he was accepting new money as recently as March.

SEC CONNECTION. It's likely that Slatkin's credibility before the SEC was enhanced by his choice of counsel. Through much of the SEC's investigation, Slatkin was represented by Gerald E. Boltz, a partner in the prestigious St. Louis-based law firm of Bryan Cave LLP. Boltz is also a former manager of the SEC's Los Angeles office. The SEC Bowers wouldn't comment on Boltz's connection. Says Boltz: "We reported the information that was reported to us, which we believed to be accurate."

Slatkin is believed to be staying at his Santa Barbara estate with his wife and two sons. Slatkin's bankruptcy filing lists debts in excess of \$100 million in assets of less than half that. Slatkin's lawyer Sun says his client is negotiating a settlement with the SEC, but that would still leave a bankruptcy filing three investor lawsuits, and an FBI investigation for him to contend with.

One thing is clear: When it comes to investing your money, don't take anybody's word as gospel.

By Christopher Palmeri in Los Angeles, with Christopher Schmidt in Washington

Slatkin says he charged no fees. But an ex-client says his contract gave Slatkin 20% of profits

"In today's market doing nothing could be risky."

[Commentary on today's market.]

by Charles R. Schwab

Some of your investments probably got hit hard recently. High tech, overseas, the Dow, it hasn't been pretty.

But I believe

did as will this one.

Now, can I or the Schwab analysts with all their facts and figures tell you when that will happen?

Absolutely not. We're not magicians.

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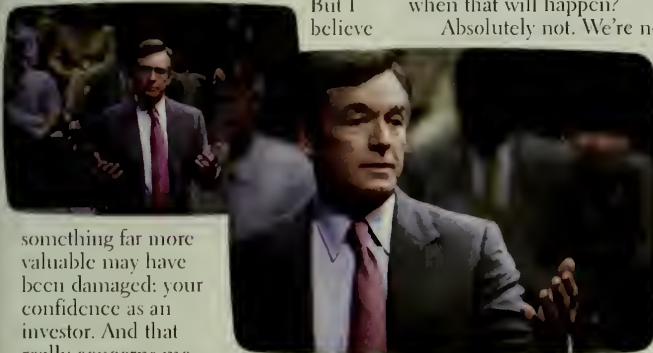
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something far more valuable may have been damaged: your confidence as an investor. And that really concerns me.

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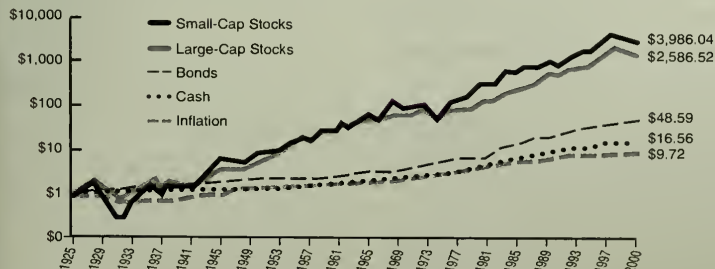
WILL THIS DOWNTURN EVER END?

Yes, obviously we have been experiencing a market correction. But no, I don't believe it will go on forever.

Why do I think this? In my years as an investor I've seen twelve such drops, including this one.

The Schwab Center for Investment Research® tracks and analyzes market moves like this and uses the past to provide perspective on the future.

We can tell you that some drops only lasted a matter of months, and a few took years to end, but end they all



The chart above illustrates the growth in value of \$1.00 invested in various financial instruments from 1925 through 2000. Figures above indicate the value of that same \$1.00 at the end of 2000. Note: Results assume reinvestment of dividends on stocks and coupons on bonds, and no taxes or transaction costs. Generally, small-cap stocks are in the bottom 50% of publicly traded companies based on market capitalization. These stocks are subject to greater volatility. Source: Stocks, Bonds, Bills & Inflation 2001 Yearbook. © 2001 Ibbotson Associates, Inc. Based on the copyrighted works by Ibbotson and Sinquefeld. All rights reserved. Used with permission. The indices representing each asset class are S&P 500 Index (large-cap stocks), CRSP 6-10 Index (small-cap stocks), Ibbotson Intermediate U.S. Government Bond Index (bonds), and 30-day Treasury bills (cash). Indices are unmanaged, do not incur fees or expenses and cannot be invested in directly. Past performance is no guarantee of future results. Schwab Center for Investment Research is a division of Charles Schwab & Co., Inc. © 2001 Charles Schwab & Co., Inc. All rights reserved. Member SIPC/NYSE (0301-13190).

COMMENTARY

By Emily Thornton

NOW BROKERAGES HAVE TO 'PAY (MORE) TO PLAY'



It must have been a frustrating moment for Merrill Lynch Chairman and CEO David H. Komansky. On May 11, the captain of America's No. 1 retail brokerage acknowledged in a CNBC television interview that, in theory, combining Merrill's investment-banking muscle and HSBC's huge balance sheet could "make sense." His remarks sparked a flurry of speculation that London-based banking giant HSBC Holdings PLC planned to take over Merrill Lynch & Co.—even though Komansky repeatedly said no deal was in the works. "You don't merge with someone twice your size. You get acquired. We don't want to be acquired," he emphasized on May 14. HSBC denies a pending deal, and analysts don't expect one any time soon.

But the buzz highlights the latest woe on Wall Street. "The continued speculation underscores the need for scale and the growing importance of the balance sheet in the investment banking business," says Henry McVey, securities-industry analyst at Morgan Stanley. What McVey means is that in a world of decimated initial public offerings and mergers and acquisitions, investment banks are now being forced to offer all types of financing to clients, including credit lines, to land lush investment banking deals. These offers take the form of everything from bridge loans to low-margin commercial paper. "It is what is being called on the Street 'pay to play,'" says Tanya Azarchs, manag-

ing director of financial-institution ratings at credit rating agency Standard & Poor's Corp. "If brokers want to play in the sweet spot of the market, they also have to pay."

It's a thorny issue that is not going away any time soon. Megabanks such as J.P. Morgan Chase Co. and Citigroup Inc. are on the warpath. They believe that by offering companies a one-stop financial shop where they can get everything from credit to merger advice, they can grab investment-banking business from rivals Goldman Sachs, Morgan Stanley, Merrill Lynch, and Lehman Brothers. "We love markets like this," says Donald McCree, co-head of the North American credit-markets business at J.P. Morgan Chase. "We view it as an opportunity to gain clients."

To some extent, they're right. On May 9, J.P. Morgan, a unit of J.P. Morgan Chase, earned \$34.5 million

for jointly issuing \$11.8 billion in corporate bonds for a new client—long-distance phone service operator WorldCom Inc.—with Salomon Smith Barney, a unit of Citigroup. J.P. Morgan believes it landed what turned out to be the largest-ever bond deal for a U.S. issuer partly because it was also able to help the company out with a \$4.5 billion loan. Salomon

NO DEAL?

Komansky is denying rumors of a merger with HSBC's Chairman John Bond (left)

Smith Barney now ranks as the No. 2 issuer of both debt and equity worldwide, with a market share of 11.7% (chart). And it is quickly gaining share in equity underwriting, handling

9% of all equity issued worldwide so far this year, up from 7.6% in 2000, according to Thomson Financial Securities Data Corp.

PRESSURE COOKER. Brokerage executives acknowledge they may need to use more of their own capital to finance deals. Gone are the days when a little good advice guaranteed a successful IPO. "We are under pressure to help clients finance deals. We will respond as always using our balance sheet with caution," Morgan Stanley Chairman and CEO Philip J. Purcell said at a Goldman Sachs financial-services conference on May 14.

The problem for investment banks is that it is more difficult for them to lend at razor-thin margins. Unlike banks, they do not have cheap deposits to draw from. Moreover, investment banks must value their loans each day at market prices, which forces them to acknowledge potential losses on their positions.

Does all of this mean that brokerages like Merrill will give up the fight—and their independence? "Companies with delicate cultures like Merrill are going to be very wary of changes," says Guy Moszkowski, securities-industry analyst at Salomon Smith Barney. But creating a balance sheet that would rival Citigroup's by teaming with HSBC sure would make Merrill's life easier.

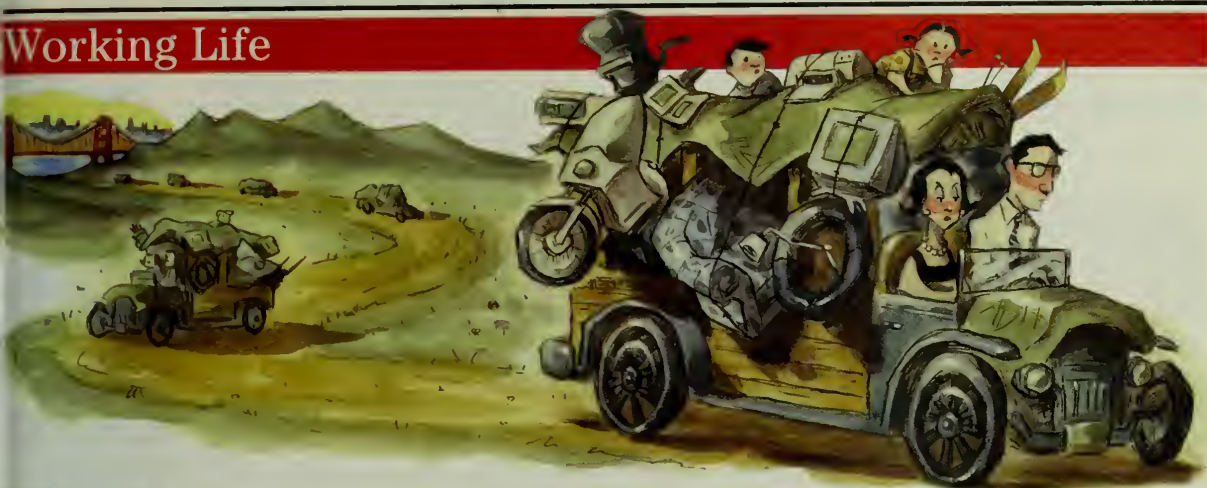
Thornton covers investment banking in New York.

HOW THE PLAYERS STACK UP

Global Debt and Equity Issuance
Jan. 1 to May 16, 2001

MANAGER	MARKET SHARE
MERRILL LYNCH	12.7%
SALOMON SMITH BARNEY	11.7
CREDIT SUISSE FIRST BOSTON	8.6
MORGAN STANLEY	7.9
J.P. MORGAN	7.9
GOLDMAN SACHS	6.5
LEHMAN BROTHERS	6.1

Data: Thomson Financial Securities Data



IGRATIONS

CALIFORNIA, HERE I GO

dot-commers are fleeing Silicon Valley in droves

Listen closely in the crowded dining room of Silicon Valley's powerbroker haunt Il Fornaio, or at the \$30-per-night nightclub Ruby Skye in San Francisco, and you'll hear the conversations taking a new turn. Instead of describing the latest "total performance delivery migration solution" or pining for the days of Ariba at \$152, the talk is reminiscent of when geologists first discovered that the state was slowly sinking into the Pacific Ocean: We better get out of here.

Now that the dot-com crash has varnished the dreams of instant millions, what was until recently the hottest place in the country has for many become like a stock to be dumped. Call it the Bay Area bailout. Some are leaving because, even with six-figure salaries, they are living like college students, crammed into 500 square feet and not saving a dime. Others can no longer afford their obscene rents or mortgages now that they have been laid off. Then there is the cashout crew, those selling their houses for double what they paid just two years ago and settling in cheaper climes, such as Palm Springs, Atlanta, Chicago, and Austin, Tex.

REASONS. Their reasons for fleeing may be different, but nearly all agree that the high-tech revolution, with all of its enormous wealth, has made the place so expensive that even doctors can barely afford to live in San Jose. It's so crowded that if you want to see a movie

you have to leave hours ahead of time just to get a parking spot and a seat. The two-hour commutes to travel 25 miles, the \$1 million-plus tear-down houses, the crowds, the blackouts, the taxes, the cell phones, the sneers—they just don't seem worth it anymore. "We were living like I worked at Starbucks," says 33-year-old Megan Tobin-Jones, a former \$140,000-a-year marketing vice-president at content management company Trapezo Inc., who recently moved to Summit, N.J., with her husband and two kids. "We feel like we got out just in time."

Nowhere, perhaps, is the trend more evident than in the once exploding real estate market, where agents across San Francisco and Silicon Valley say many of their sellers are joining the out-migration. "It's the recurring theme among the sellers I'm representing now," says Dan Bunker of San Francisco's Zephyr Real Estate. "They want to get out before things get worse." Whereas just a

year ago you couldn't find a dumpy studio in San Francisco to save your soul, landlords are now doling out signing bonuses to renters by kicking in a month free. Bidding wars for high-end homes in the hills are over, with prices falling 25% off their year-ago high. And rental listings in the Bay Area are at their highest level since 1992, with the corporate rental market down 50%. "It's not like there are any jobs to go to, so people are leaving," says Zoya Smithton, CEO of Bay area rental-unit provider American Marketing Systems Inc.

BLOATED. Even those who have made plenty from options are taking flight. Mark Milinkovich, a 39-year-old former manager at Cisco Systems Inc., recently resigned after seven years to return to his home in Ottawa, Ont. As Cisco grew, he says, its lean, mean cowboy culture was supplanted by a bloated bureaucracy of complacent, vested employees that Milinkovich calls VIPs (vest-in-peacers)—who weren't as much fun to work with as the original crew. He also got tired of living his life on airplanes, all to bank a few more zeroes, and then return home to see the camping equipment he bought for trips with his 3-year-old son languishing unused in the garage. "My son is now 8, and I have yet to take him camping," he says.

For those staying put, there's hope that now that every fortune seeker isn't heading for the Valley, the traffic may ease, the crowds may thin, and housing costs may sober up. "From a regional perspective, we're getting back to a pace that's sustainable," says Doug Henton, president of Palo Alto advisory firm Collaborative Economics. Why, just the other day, an 1,800-sq.-ft. tear-down in Atherton actually sold for under its asking price. The bad news? It was still \$3 million.

By Michelle Conlin in New York, with Doug Robson in San Mateo, Calif.

Paradise Lost

Why people are fed up with the Bay Area

- ▶ Two-hour commutes
- ▶ Ordinary houses costing millions
- ▶ No jobs, no parking, no electricity
- ▶ Lines at restaurants and movies

CHAIRMAN OF THE BOARD

How shoemaker Vans turned itself into skateboarders' fave

Skateboarding has come a long way since roller skates were first nailed to a slab of wood. The sport has spread beyond a few maverick teens practicing their flips and spins on city streets and in empty swimming pools. But reaching them has proved tough. More than one athletic shoe giant has stubbed its toe trying to play to skateboarding's rogue image.

These days, the brand of choice is tiny Vans Inc. The Santa Fe Springs (Calif.) company, which pioneered thick-soled, slip-on sneakers able to absorb the shock of a five-foot leap on wheels, maintains its cool image with an offbeat marketing mix. Instead of relying heavily on mass media ads, it goes in for events, sponsorships, and even a documentary film to celebrate the outlaw nature

of skateboarding culture. Its sales centerpiece: the elaborate skateboard parks Vans is building at malls around the country, venues that usually ban skateboarders. "Our vision is not to hit our target audience over the head with ads, but to integrate ourselves into the places they are most likely to be," says Vans CEO Gary H. Schoenfeld.

With the skateboarding craze still hot, that's translating into heady growth for Vans, which sells through its own chain of 140 stores as well as independents. Earnings will climb 38%, to \$15.5 million, on sales of \$336.4 million—up 23% for the year ending in May, estimates analyst John J. Shanley

of Wells Fargo Van Kasper. True, that gives Vans just a point or two of share in an overall athletic shoe market half-owned by Nike Inc. and swarming with up-and-comers. Still, by staying true to its base of alternative-sports fanatics, the company has built an intensely loyal customer base. As apparel sales struggled during last year's difficult holiday quarter, Vans's same-store sales rose 16.3%. Orders for this fall's back-to-school season are up 25%.

The company's skateboard parks are helping it branch out beyond hardcore street-skaters to kids willing to pay \$14 for two hours of skateboard-

ing. Eight of its parks have already opened at upscale malls around the country, and a ninth, with 50,000 square feet of wood ramps and concrete bowls, opens in June in Denver. The brand-building potential is obvious.

"I wouldn't wear anything else. I like just about anything Vans sells," says Tom Ward, 15, of Cherry Hill, N.J., who has visited the new park in nearby Moorestown five times since it opened a few weeks ago.

Now Vans is about to get some big-time media exposure. The company's 21-event Vans Triple Crown showcase for sports ranging from skateboarding to BMX biking, is moving from ESPN to NBC Sports, where coverage begins on May 19. And *Dog Town and Z-Boys*, a Vans-financed documentary narrated by Sean Penn that chronicles skateboarding's early days, has been picked up for distribution by Sony Pictures Classics.

WIMP WATCH. But if Vans wants to keep its momentum, it will have to offer new products without offending the loyalists who love its maverick roots. The company has moved into snowboard boots but steered clear of inline skates. Why?

To keep the faith of skateboarders who consider inline skating a wimpy shoot. It's also experimenting with hiking boots, an expanded women's collection, and a clothing line with partner Pacific Sunwear of California Inc.

Still, there's always the risk that the fad will fade or that someone could invade Vans territory, as Nike tried to do in 1995. Schoenfeld doesn't believe the major

brands have the right stuff to reach the rebellious market. "I have a tough time picturing Tiger Woods on a skateboard," he quips. "These kids know who's authentic." Still, he'll have to be nimble to make sure Vans doesn't get chased out of the market like a skateboarder on busy street.

By Arlene Weintraub in Los Angeles with Gerry Khermouch in New York

TRICKY FEAT

To keep its momentum, Vans has to offer new products, such as snowboard boots, that won't offend loyalists



WHEEL THING

Vans has already opened eight skateboard parks at shopping malls across the country



Lotus

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business

Winning Back The Web Wary

For tech-shocked investors, the Street now has online hand-holding

► BY MIKE McNAMEE

Welcome to Stage II of the Internet investing revolution. In the Web's infancy, "online investing" meant online trading—real-time quotes, \$8.95 commissions, millisecond market access, and hip young guys teaching old fogies how to make their computers boogie to the

beat of an ever rising Nasdaq. But the music stopped 14 months ago, and millions of investors discovered that a speedy trade can mean you just lose your money faster. Markets may be showing signs of life, but Web trading is still in a coma. On-line trading volume is down 40%, and E*Trade and Ameritrade are laying off employees and slashing marketing budgets.

Now it's time to put the investing back in online investing. Wall Street's new Internet emphasis is advice—from financial planning to stock-picking to money management. Old-line brokerage houses and online upstarts alike are searching for the right amalgam of tech and touch, combining powerful Internet tools for calculation and communication with human insights into investors' needs and desires.

PHONE CALLS. For today's investors, stunned by the meltdown of their tech-heavy portfolios, it's a welcome trend. Brokers say they're seeing heavy demand to learn more about money-management basics: diversification, asset allocation, holding down taxes. People want to rediscover investments and market sectors that barely registered a blip on '90s trading screens, from bonds to energy stocks. Wealthier customers who used online trading accounts as their "play money" are bringing what's left back to their full-service brokers. And novices who



BusinessWeek Investor

thought they could go it alone are looking for the comfort of human contact.

Wall Street's advice offerings will determine who shares in the trillions likely to accumulate as the baby boomers age in the next decade. More than half have yet to hit their 45th birthdays—historically the start of each new generation's peak earning and investing years. As they turn to Wall Street, they bring their finely honed consumer expectations to their new role as savers. "Boomers won't choose between getting professional help and having control. They say: 'I'll have both,'" says Daniel Leemon, chief strategy officer for Charles Schwab. "And they want both at very low cost, with flexible ways to pay."

What's emerging is a have-it-your-way menu of investment help. For the majority of investors who want an active relationship with an adviser, new online services are making it easier to find

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INVESTING**

and collaborate with independent financial planners or money managers across the country (page 103). Internet technology is also slashing the cost of money management, bringing personalized separate accounts and tax-efficient baskets of stocks called folios into reach for the mutual-fund masses (page 105). And do-it-yourselfers—about a quarter of the 19 million affluent households with net worth exceeding \$500,000—will find that the Web's tools for cyberadvice and trading are still improving (page 110).

"A SHOVE." But for most investors, the Web's biggest impact will be on the advice offerings of big brokers, whether online or old-line. What sort of help can you expect? Online brokers are adding human contact to their cyberadvice. E*Trade, for example, will soon roll out a combination of computer- and phone-delivered solutions to investors' questions, backed by the expertise of Big Five accounting firm Ernst & Young. Fidelity Investments' next-generation Portfolio Planner, due in June, will aggregate all of your Fidelity accounts with online statements from other firms, x-ray mutual funds to uncover their component stocks, and analyze your entire financial life by asset type, industry breakdown, and risk profile. While you're online, a Fidelity phone rep can watch the screen you're working on and guide you.

Online advice still puts a big burden on users: You have to figure out the right questions to ask, and then you must be moved to act on the results that you get. "When it comes to

From financial planning to stock-picking to money management, Wall Street's new online emphasis is advice. Old-line firms and upstarts alike are searching for the right mix of tech and touch, of power tools and human insight



making investments, people usually need a shove," says John Rekenthaler, who heads the online advice unit of Morningstar. "Online advice without the human push usually won't go anywhere."

That's where the Wall Street giants—written off as dinosaurs by e-commerce gurus—have the edge. True, they've been clumsy in using technology; most are just now letting brokers send e-mails directly to clients. But they're rapidly adding cybertools to let investors track portfolios and figure out their own investment mixes. Brokers can monitor the results and follow up with specific recommendations. "It's counterintuitive, but we've found that when an investor uses a self-service analytic tool, her appetite to talk to her adviser increases," says Martin Hoekstra, group head of markets for UBS, the Swiss parent of UBS PaineWebber.

CONSISTENT YARDSTICK. At Salomon Smith Barney's Web site (table), you can search for a broker by specialty, such as retirement or college saving; investing style, or shared interests (a Penn State alum who coaches Little League). Once you have signed up, you can get an aggregated statement of your accounts at SSB and any

it comes time to pick stocks, the broker can insert links to SSB research, news articles, and Webcasts into your statement page, where you see them the next time you log on.

For customers, the online push is likely to improve the big brokers' advice. Online too highlight the products a client needs—not the ones that a particular broker knows best and peddles to every prospect he meets. Cybertools also give you a consistent yardstick for measuring your broker's recommendations: If the asset model says you should put 10% of your money in foreign stocks, you're likely to

question your broker when he suggests you put 20% in an emerging-market fund. And investors can now check track records of many firms' analysts, using such Web sites as Bulldog-Research.com, before deciding whether to act on that hot "buy" recommendation.

How should you pay for advice? Most online brokers don't charge directly, hoping the offerings will attract bigger accounts. (The average



"When an investor uses a self-service tool, her appetite to talk to her adviser increases"

other institution that posts statements online. With your broker—in person or while sharing screen views on separate PCs—you can use calculators to analyze your goals and see how your asset mix fits with SSB's recommendations. Automated account-tracking and cybertools for basic goal-setting let clients and brokers "get past the introductory stuff and start their conversations at a higher level," says Stephen Clifford, who heads SSB's interactive marketing. And when

account in 2000 at E*Trade was just \$12,000, which is typical of online discounters, says analyst Richard Repetto at Putnam Lovell Securities.) At full-service firms, investors are flocking to fee-based accounts, paying 1% or so of their account balance each year instead of commissions for even trade. The fees remove a broker's incentive to push you into unnecessary trading—but for inactive investors, they can be expensive. Charles Schwab is taking a fee-for-service approach: Its onetime \$400 Portfolio Consultation offers clients a thorough financial checkup using a combination of Web tools and local brokers. After discussing the results with a broker, a client can monitor the progress toward meeting the recommendations via the Web.

Online trading might have been the first killer app for Internet investing services—especially in a historic bull market. But as the boom fades and a distant memory, suddenly being the one in sole command of your financial life doesn't seem so appealing. The Web's real promise will be realized when it helps you pair up with the right pros for the support you need. The advice you want, the way you want it—that's what online investing sites are starting to deliver.

FINANCIAL ADVICE IN NEW GUISES

(WWW.)

ETRADE.COM Firm is teaming up with Ernst & Young to offer online and phone advice

FIDELITY.COM Portfolio analysis breaks down holdings of Fidelity and outside funds

MERRILLYNCH.COM Clients can compare Standard & Poor's stock research with Merrill's analyst reports

MORGANSTANLEY.COM Will soon offer direct feeds of clients' data from other institutions into unified financial statements

SALOMONSMITHBARNEY.COM Broker can "embed" research reports, Webcasts in customers' online statements

SCHWAB.COM Portfolio Consultations combine online tools with brokers' advice in financial plans

UBSPAINWEBBER.COM Real-time reports on performance of firm's money managers vs. the market

BusinessWeek online

For live links to the investing sites covered in this package, go to the May 28 issue online at www.businessweek.com. Tap into our investing advice offered in partnership with Standard & Poor's, and set up a portfolio on our investing channel.

See all your financial assets in one place.

Now there's a free* way to see all your online financial assets in one place: Fidelity's Full View.SM Simply input all your different accounts one time: investments (both with Fidelity and other companies), bank accounts, 401(k)s, even credit cards. From then on, Full View will automatically



update, organize and track them for you. It's the easy way to see your comprehensive net worth. And your information is always protected with Fidelity's advanced technology. Open a Fidelity AccountSM and set your Full View up at Fidelity.com. And see yourself succeeding.

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▼ Financial Snapshot

Account	Balance
Fidelity Accounts	\$195,661.25
Other Investment Accounts	\$135,288.13
Mortgage	- \$89,837.66
Banking	\$24,351.78
Credit Cards	- \$5,793.65
Account Balance Total	\$259,669.85



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Online Advice: Remote and Reassuring

More investors are finding savvy guidance on the Net

BY LEWIS BRAHAM

Scott Noyce is one of a new breed of online investors. The 39-year-old marketing executive with CRT Group has scant interest in managing his investments. So he delegates that task to a financial adviser, Thomas Lydon of Global Trends Investments. That Noyce works in Boston and Lydon in Newport Beach, Calif., is no obstacle. Noyce receives market updates from Lydon via e-mail, and they have private online chats at Lydon's Web site, global-trend.com.

Using software called LivePresentation, Lydon displays relevant charts and graphs as he and Noyce meet online. During a recent session, Lydon demonstrated the virtues of portfolio diversification, posting a graph of value funds' recent tri-

PRIVATE CHATS:
Global Trends' Lydon posts charts during his online client sessions

umph over growth. "It was just like an office visit," Noyce says. These days, investors such as Noyce are eclipsing the do-it-your-

selves online, and advisers are accommodating them with sites that provide different levels of services—from access to sophisticated financial-planning tools to cyber hand-holding.

According to a recent survey by Forrester Research, 35% of investors—whether online or off—are "delegators" who choose to put their money in the hands of a professional. Another 55% are "validators" who want to control their own finances, but occasionally need an adviser to vet their decisions. "If you've got \$250,000 in your 401(k), you want some affirmation that what you're doing is right," says Michael Scarborough, an Annapolis (Md.)-based 401(k) adviser. "You're not going to just rely on an Internet tool."

"HOLISTIC ADVICE." To serve the needs of delegators, many sites provide access to full-service advisers, such as Lydon, who will manage money for a percentage of assets. LiveOffice, which built Lydon's site, has done the same for 6,500 other advisers. For validators, who often have less money, such hybrid sites as Financeware.com and Quicken.com offer advanced financial planning tools, but also give investors the option of paying for advice. Some sites let you hire an adviser for just a financial plan, pay per month for advice, or even pay per question.

Delegators looking for advisers should first check industry resources such as Napfa.org, which links you to sites of financial professionals who work in your area (table, page 104). For a more detailed investigation, visit InvestorTree. Its IntelligentMatch system will ask about planning services you need, your risk tolerance, and your preferred investment style. It even asks if you prefer a male or female planner and whether you want one fluent in a foreign language. Then it provides detailed résumés of planners who match your criteria. Some résumés have a "Verified" logo, meaning that InvestorTree has checked out the planner's credentials.

One problem with advisers is that few have the expertise or resources to manage your entire financial life. The planner handling your portfolio rarely does your taxes, and your accountant may know nothing about life insurance. One site, MyCFO, tries to remedy this problem. It aggregates information on all of your accounts, trusts, property, insurance policies, and taxes. A team of MyCFO accountants, lawyers, and financial planners then uses that information to give "holistic advice," hiring money managers, filing your taxes, even paying bills. And every transaction registers at the same site.

The cost of that service ranges from just

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0.15% to 0.65% of assets, which is relatively inexpensive—but you have to meet the \$10 million minimum. The firm has gathered \$45 billion in assets in just two years of operation. Although the site aggregates all the information and links advisers, “80% of our work is face-to-face or over the phone,” says MycFO Chief Operating Officer Frank Tirelli. He hopes to offer MycFO—with slightly less face-to-face service—to single-digit millionaires soon.

DRIVER'S SEAT. Validators will find advice more accessible. One worthwhile site is EXP. Instead of paying a percentage of assets, investors only pay for answers to the questions they ask. The site lists 348 financial planning experts, each of whom charges a per-minute fee to talk on the phone or per-question to send answers via e-mail. EXP gets a share of the fee. By clicking on an adviser's hyperlink, you get a detailed snapshot of the person's credentials. A black check next to an adviser's name means the site has checked out the credentials. Users can also rate the quality of advice from one to five stars.

CLIENT NOYCE:
“Like an office visit”

Jennifer Garza used EXP to do her taxes. The 23-year-old San Jose (Calif.) resident became an independent contractor last year at a travel agency and was confused about her tax liability. She liked the fact that the credentials of her adviser, Carl Phillips, had been checked out. Also, Phillips answered her initial questions for free. She paid an extra \$100 to



have him file her return. “It was a lot cheaper and more trustworthy than going to the yellow pages, starting at ‘A’, and calling down the list she says.

Validator sites put investors in the driver's seat. At Financeware.com, you can design your own financial plan using a technique called Monte Carlo simulation that tests the probability of achieving your investment goals. Or you can submit your plan anonymously to a network of more than 2,000 advisers. Those interested will vie for your business by running their suggested improvements to your plan through Financeware.com's probability test. You choose from the advisers with the highest probabilities of success.

Unlike Financeware.com, Quicken's 401k Adviser, at quicken.com/retirement, focuses on 401(k)s. You can design your own financial plan for free or opt to pay \$19.95 a month for an adviser who will guide you over the phone. These advisers have access to a database of 1,100 401(k) plans. They've studied the mutual funds in each and know their strengths and weaknesses. If your plan is missing, say, a small-cap fund, the advisers would suggest how you can reallocate assets to achieve the optimal diversification.

The one risk of validator sites is that they can be too flexible for unschooled investors. If you delegate your control to an adviser, he or she implements the financial plan for you. But validator sites give you the tools to do it yourself. “Online financial tools are a lot more complicated than a hammer,” says David Loeper, chief executive of Financeware.com. “If investors can't build their own deck or do their own plumbing, they may not be able to design their own financial plan.” Good advice is worthless if not taken.

ONLINE INVESTING

FINDING AND VETTING ADVISERS

ADVISER SITES (WWW.)	COMMENTS
FPANET.ORG/PLANNERSEARCH	Searches for certified financial planners by zip code; includes some planners' résumés
INVESTORTREE.COM	Most advanced search site, but includes only 500 advisers; verifies credentials of some
MONEYCENTRAL.MSN.COM/INVESTOR/DALBAR	Advisers have five years' minimum experience and clean records, but they pay to be included
NAPFA.ORG	Allows zip code search and provides links to fee-only advisers' individual sites
NEWS.PORTFOLIOCORNER.COM*	Detailed adviser referral search, but no credential verification
REGULATORY SITES (WWW.)	COMMENTS
CFP-BOARD.ORG/CONS_MAIN.HTML	Checks the background of certified financial planners for violations
NAIC.ORG/CONSUMER.HTM	Provides violation records of insurance advisers
NASAA.ORG	Researches violation records of investment advisers managing less than \$25 million
NASDR.COM/2000.HTM	Reveals actions against brokers or advisers managing more than \$25 million in assets

*Web site address doesn't use www.



When You Need Just A Little Hand-Holding

...es for investors who want advice and autonomy

BY SUSAN
HERREIK

Dr. Richard Hamburg lost his zest for do-it-yourself online investing after his tech-laden \$1 million-plus portfolio plunged 40% in the past year. But the 48-year-old Smithtown (N.Y.) plastic surgeon hasn't lost his desire to invest online. He's just doing it differently. Instead of trying to figure out what's hot in the market and then trading through his Schwab account, he has signed up with a site called WrapManager. Now, professional money managers do the stock-picking for him via a handful of managed accounts, though he still has a say in shaping his portfolio. "In this kind of market, you have to pay close attention to your trades, and I don't have time for that," he says.

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Sites like WrapManager appeal to online investors seeking a middle ground: They want some professional advice but not the extensive hand-holding that comes with a financial planner or full-service broker. Such investors also want greater diversification at lower cost than they can get from buying individual stocks, plus more flexibility than is possible with one-size-fits-all mutual funds. "This isn't for everyone," says Ryan Tagal, a senior analyst at Boston's Cerulli Associates, which tracks online money management. "You've got to be comfortable handing over potentially large sums of money to people you haven't met."

FOLIOS. For those who are, these sites offer more convenience and lower fees than you find offline. WrapManager, for instance, charges 1.25% of assets annually, well below the 1.89% average for managed accounts sold through brokerages and financial advisers. Hamburg says a big reason he selected WrapManager is that he visited a local brokerage office that charged twice as much for access to an almost identical list of managers.

Investors who want to go this route have two options (table, page 106). In addition to the online managed accounts offered by WrapManager, E*Trade, and CSFB-direct (formerly DLJ Direct), you can buy "folios," or preselected baskets of stocks. Folio sites offer some advice but not active management—the investor makes the trading decisions. Also, you don't need big sums to invest in folios, some of which carry no minimums, while managed accounts require a minimum of \$100,000 per account. Currently, only FOLIOfn and Netfolio offer folios, but Fidelity Investments and E*Trade plan to roll them out in June.

If you decide on an online managed account, you'll need to invest \$500,000 to be sufficiently diversified, Tagal says. At WrapManager, you could pick from any of 120 accounts. Each focuses on a specific investing style, such as large-cap growth or small-cap value; an industry sector, such as energy or technology; or an asset class, such as bonds. Some 60 managers, who oversee investments for wealthy individuals, institutions, and mutual funds, run them.

WrapManager offers the most help in selecting accounts. After you answer a brief online questionnaire to determine your investing goals and time horizon, an adviser calls you within minutes to suggest several managed accounts that fit your needs. Hamburg's adviser recommended that he more broadly diversify his tech-heavy portfolio, which included big chunks of Cisco Systems, Juniper Networks, and Microsoft. So the doctor selected

get active management, you have to invest at least \$100,000. But guided folios require \$5,000 or less

Even with Netfolio's cheapest option, you get an annual heads-up of which stocks you should sell and which you should keep to get the best tax outcome

five accounts, including one that invests in convertible bonds. "I would never have thought of convertible bonds on my own," he says. While he ceded control of his portfolio, Hamburg can still customize his accounts. For instance, he asked that EMC be excluded from a tech-oriented account since he already owns shares.

One drawback at WrapManager is that you can't look at the full list of its managed accounts, as you can at the E*Trade and CSFBDirect sites. E*Trade offers 68 accounts, which you can rank by one-, three-, or five-year performance. Unfortunately, the performance data run only through Dec. 31, 2000. You must call E*Trade for more recent figures. CSFBDirect offers just six accounts but boasts the lowest annual fee for totals over \$500,000—0.9% of assets.

Folios don't offer professional management, but they do provide a framework for picking stocks as well as instant diversification. FOLIOFN customer John Sudduth, a Colorado Springs (Colo.) veterinarian, owns a stock basket based on the site's popular biotechnology folio. "This way, I can bet on medical technology without having to figure out which couple of companies will be the biggest winners," he says. Because Sudduth is keen on companies developing novel medical therapies, he pared FOLIOFN's ready-made list of 30 stocks down to the 12 that best reflect his theme.

ONLINE INVESTING BUILD YOUR OWN. FOLIOFN, started a year ago by Steven Wallman, a former commissioner at the Securities & Exchange Commission, offers more than 120 preset folios, each comprised of 5 to 50 stocks. Mainly, they are based on market indexes, stock sectors, investing styles, or asset classes. Also, investors can build their own folios. The site has no minimum and charges \$295 a



DR. RICHARD HAMBURG
A live broker would have cost double

year to set up three folios. The stocks can be traded twice a day, making folios popular with frequent traders. The site also has advisers on hand to answer questions. "We won't tell you whether you should pick IBM over Hewlett-Packard, but we explain how a riskier folio might behave compared to a less risky one," says Wallman.

Netfolio, launched in March by James O'Shaughnessy, a money manager and author of the 1996 best-seller *What Works on Wall Street* (McGraw-Hill; \$29.95), puts more emphasis on giving advice. Customers who invest more than \$100,000 and pay \$1,000 or more a year for premium service get an adviser to guide them and handle trades. Even Netfolio's basic service, which costs \$200 a year and requires only a \$5,000 minimum, provides customized advice. For instance, Netfolio will tell you which stock to sell or retain to minimize your tax bill.

Remember that online money management is still a fairly new and untested area. RunMoney, for example, started a year ago to offer managed accounts to individuals, but now deals only with financial advisers. E*Trade bought PrivateAccounts.com to form the basis of its program. Hamburg says he asked WrapManager what would happen if the site shut down. He was assured that Wexford Clearing, a Prudential Securities subsidiary that handles WrapManager money, would continue to hold his assets. Similar to Bear Stearns, which holds Netfolio's assets in custody.

It's tough to be a solo stock-picker. The beauty of the Net is that you can get the help you need without losing the independence that makes you a Web investor in the first place.

WEB MANAGERS

WEB SITE (WWW)	MINIMUM/COST	DESCRIPTION
CSFBDIRECT.COM	\$100,000/ 1.25% of assets	Just six managed accounts, lowest fee on large sums
ETRADE.COM	\$100,000/ 1.5% of assets*	Click on Personal Money Management to hook up with pros who run 68 accounts
FOLIOFN.COM	None/ \$295 a year	Provides 120 ready-made stock baskets called folios
NETFOLIO.COM	\$5,000/ \$200 a year**	Gives advice on managing its 240 folios for tax efficiency
WRAPMANAGER.COM	\$100,000/ 1.25% of assets	Offers 120 managed accounts and help in picking them

*Fee for typical account

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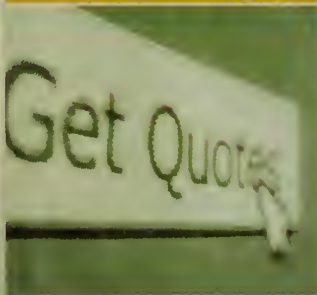
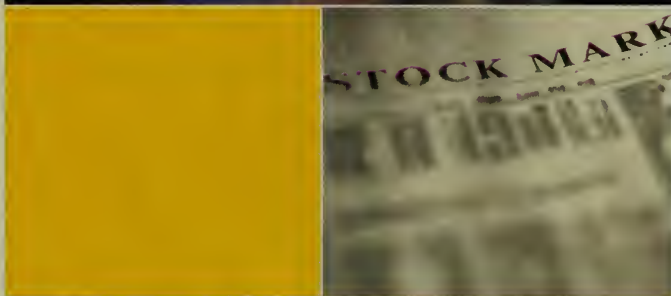
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The Best Tools For the Job

Useful sites for smart investors

► BY CAROL MARIE CROPPER

Despite a spate of site closings and fees, lots of freebies remain that are well worth your time

Now comes the hard part—making money in a market where everything isn't going up. For that, you're going to need some serious tools. Logging onto one of those chat rooms populated by pompous pundits oh-so-sure which stock will be a winner won't cut it any more—as if it ever did.

Unfortunately, just when you need them most, some of the Web's best tools are nowhere to be found. Sites like Stockmaster.com went out of business, while others, such as Outercurvefinance.com, stopped dispensing free information, deciding to sell their wares to the brokers, brokerages, or mutual fund companies that would pay. Even FreeEDGAR has stopped providing some of its free tools, sending users to a sister site, Edgar Online, where they cost \$9.95 a month. Still, with at least 15,500 investor sites out there, a bounty of free calculators, screening tools, and information resources remain (table, page 112). And before you pay for a tool you just have to have, check your broker's or mutual fund's site. It might be there for free.

ALL THE RAGE. Web offerings have taken a decidedly practical turn since last year's market crash, says Douglas Gerlach, founder of Investorama, which compiles and rates investor sites. Tools like Portfolio Science that help gauge the risk of an investment or portfolio are all the rage. And investors now have access to their own stock-valuation models. Even dowdy portfolio managers and asset allocators are suddenly in style.

We've gathered a handful of the most useful tools, leaning toward the more established offerings, since no one wants to share financial information with a site that's going to collapse and sell its subscription list. And we've focused

on tools that let you weigh an investment's value based on fundamentals like profits and cash flows. Technical investors who rode the momentum bull got thrown last year when the trend headed south.

For a quick visual sense of how the market is faring, check out SmartMoney.com's colorful, Facebook-like Cube-like Map of the Market. Its blocks representing specific sectors, are subdivided in the stocks within each sector. The tiny squares change from red to green, depending on whether each stock is down or up, creating a crazy quilt of winners and losers. The site offers free real-time

stock quotes to those who register.

If you're still bold enough to pick individual stocks, you'll want some screening tools. Quicken.com, from the company that makes the tax and personal-finance software, offers a particularly clear set of stock screens so you can trawl for equities that meet your own criteria, such as market capitalization and price/earnings ratio. Our own Businessweek.com boasts three screens—one for quick searches, a more advanced version that scans 74 variables (ranging from beta, or stock volatility, to cash-flow



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Tell the Bond Market Assn.'s site what state you live in, and it will tell you how big a taxable return you would need to beat a municipal

growth), and a third based on the criteria *BusinessWeek* uses in its annual ranking of companies in the Standard & Poor's 500-stock index.

Once you've got some potential buys, you can run those companies' fundamentals through a discounted cash-flow model like the one at Value-Pro. Such models have cropped up on a handful of Web sites, letting even those without an MBA run a company's numbers to come up with its value, based on things like earning power and debt load.

Since you'll want to get beyond what the analysts are saying, Nasdaq, run by the people who operate the market, lets you see if insiders are buying or selling, often a clue to a company's prospects. It carries reports for exchange-listed stocks as well. The site also provides Securities & Exchange Commission filings. (Of course you can also get them by clicking on Edgar at the SEC's site, www.sec.gov.)

Investors tormented by margin calls during last year's market slide will appreciate a tool developed by content provider Tradeworx for the SEC site. It lets you calculate the cost and risk of buying on margin—using money borrowed from your broker.

Finally, Bloomberg.com has a calculator that compares what you might earn from an investment, minus taxes and commissions, if you hold long enough to qualify for long-term gains, versus what you would earn by selling sooner (assuming no unexpected change in price).

TAX BITE. Many stock investors have recently discovered the charm of bonds, and Web sites offer help for them as well. Bondsonline lets visitors shop for bonds by various criteria, such as rating, yield, and whether the bond is corporate or municipal.

InvestinginBonds.com, sponsored by the industry's Bond Market Assn., provides a handy tool that calculates your tax bite based on your income and home state. It then presents a chart showing how large a return you would need from a taxable investment to net what you'd get from a tax-free municipal bond. Just

logging on to check your state tax rate is worth it.

Those spreading their risk with mutual funds can choose from a bevy of screens and ratings tools. One of the best comes from Morningstar, the people who have been rating funds 17 years.

Morningstar.com's screen lets you shop for funds by picking criteria such as style (large growth, small value, and so on) and level of returns. Unfortunately, one of the site's most intriguing tools—its Portfolio Stock Overlap, which sifts through the stocks your funds hold and those you own directly to reveal any overlap—costs \$99 a year. More free tools can be found in Yahoo's finance section. One lets you see how much a fund's loads and fees cut into its return.

For the mundane tasks of managing your portfolio and planning for retirement, lots of sites have tools. The best allow you to segregate taxable from tax-deferred accounts. FinancialEngines' free service is especially helpful: It tracks assets in your portfolio and doubles as a retirement tool, automatically updating your portfolio's value and projecting how much it will provide in retirement. This site reserves some features for those who pay. But many corporate retirement plans offer the souped-up version to employees.

Other sites, such as Quick-en.com, lead users through a more complicated process. But be careful. If the numbers look odd, it may be because of a glitch. The Quicken calculator on AOL.com, for instance, could not quite grasp the notion that someone might want to exceed the \$10,500 pretax contribution limit and add aftertax dollars to plump up a now shrunken 401(k). Hence, it underestimated the amount saved.

Guess nothing comes easy. Even with Web tools, you need to be a bit skeptical. □

ONLINE

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CALCULATORS (WWW.)

BLOOMBERG.COM

Figures investment returns after commissions and taxes

INVESTINGINBONDS.COM

Shows return you need from a taxable investment to equal a tax-exempt bond

SEC.GOV

Figures the cost and risk of buying on margin; SEC filings, too

YAHOO.COM

Shows how much loads and fees cut into mutual-fund returns

INVESTING HELP (WWW.)

FINANCIALENGINES.COM

Organizes your portfolio, updates its value, projects how much you'll have in retirement

INVESTORAMA.COM

Lists, rates, and provides links to thousands of investor sites

NASDAQ.COM

Gives everything from insider trade info to SEC filings

SMARTMONEY.COM

Map of the Market charts stock and sector movements in color

VALUEPRO.NET

Crunches the numbers to tell you what a stock is worth

SCREENS (WWW.)

BONDSONLINE.COM

Search for bonds based on your criteria

BUSINESSWEEK.COM

Trawls for stocks that fit your specifications

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QUICKEN.COM

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The Seven Deadly Sins of Investor Web Sites

At too many, you'll lose something valuable: Your time



BY ROBERT BARKER

rb@businessweek.com

Since both their data and advice can be wrong, you have to recheck everything those "timesaving" tools come up with

You run a huge risk investing online. And I don't only mean losing money. I'm also talking about risking something that can be just as valuable—your time. Yes, saving time is a powerful reason for going online to invest. And that's possible, but it's not a lock—not when even some of the best financial sites commit what I call the Seven Deadly Web-Site Sins:

■ **Dirty data.** The Web swiftly brings to your fingertips all kinds of real-time information. Unfortunately, not all of it is real accurate. The more you use the Web to research investments, the more you'll find yourself double-checking data. You have to watch out for even such simple facts as market capitalization.

Check, for example, the market cap of telecom giant Teléfonos de Mexico and you might "learn" that it's the world's most valuable company. By miscounting its number of shares outstanding, America Online gives the company a \$510 billion market cap—more even than actual No. 1 General Electric's \$490 billion. Meanwhile, a bunch of other sites, including AOL's archival, MSN, understate the real TelMex figure, which is around \$25 billion. So, with online data, live by Ronald Reagan's words: Trust, but verify. If a data point is crucial, take the time to confirm it.

■ **Drower warfare.** Drower? If a site isn't "optimized" for your Web browser, you'll get drowsy waiting, waiting, waiting for pages to load. Or, as with Quicken.com's portfolio tracker, you can't make full use of its functions unless you've got the right browser (in this case, Microsoft's Internet Explorer). Another time-waster: sites that penetrate corporate firewalls very slowly, so forget using those from the office.

■ **Deportation.** If you set up a portfolio at a financial site, hope the site survives. In January, when BusinessWeek Online absorbed its sibling site, Standard & Poor's Personal Wealth, it asked PW users to move their portfolio data to the BW site's different tool. If the users didn't make

time for that cumbersome job, their data got purged. Something similar may happen soon when CNBC.com merges with MSN MoneyCentral. MSN is still working on how to move user data, but CNBC.com's portfolio tracker has been sentenced to the gulag.

■ **Fuzzy math.** It would be nice to take as gospel every calculation delivered by an online tool. Don't. One of my favorite sites, myStockOptions.com, had to fix a bug last July in how it calculated the potential tax hit on exercising employee options. Moral: Before taking action—advice given by an online tool, take the time to ensure that you understand its logic and that its conclusions pass the test of common sense.

■ **Chef's surprise.** Spend more than a few moments with an online retirement-planning or asset-allocation tool, and you'll wonder: "How did come up with that advice?" Some sites don't tell you. With scanty notes on methodology and data sources, you can't peek in the kitchen to see how they cook up answers. Brokers' asset-allocation tools, such as those you can find at the Fidelity Investments and Charles

Schwab sites, are cases in point. Here's a general rule: If an advisory tool has as many disclaimers as explanations, don't waste your time.

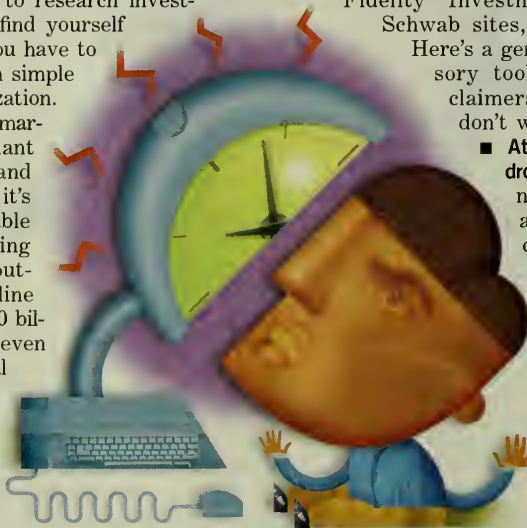
■ **Attention-gluttony syndrome.** Many sites send newsletters and e-mail alerts to keep you clicking their way. Some abuse the privilege of your attention by sending a steady stream of e-mails. When registering, see if there's a quick way for you to change e-mail options. The Motley Fool does this right, with a link in each e-mail

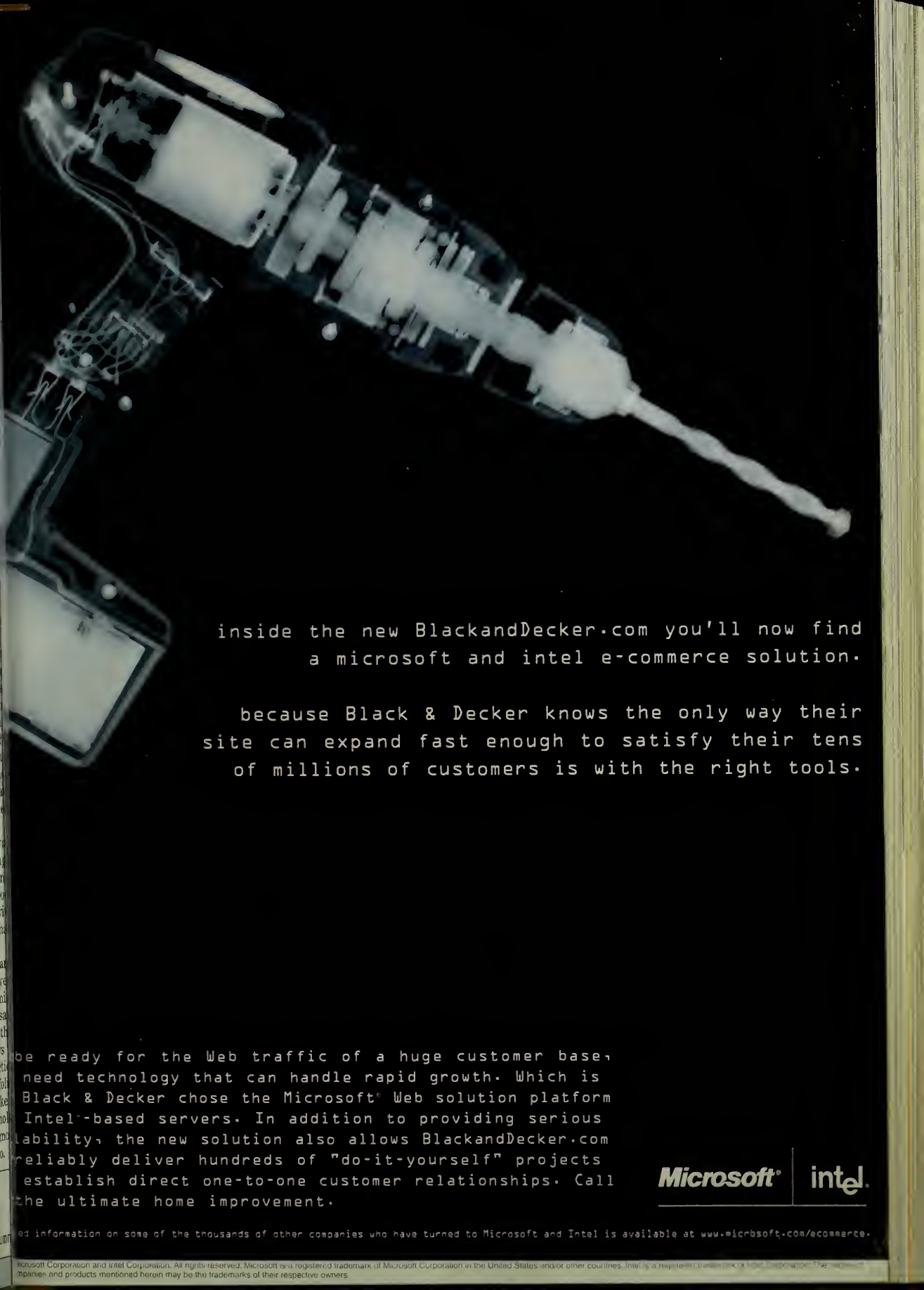
to a page for ending them.

■ **Captive data.** The biggest pot of money many people keep is in a 401(k) or other employer-run retirement plan. More and more companies let employee-investors track accounts, alter savings rates, or even trade online. Yet all turns frustrating, because few sites offer ways "export," or download, balances and transaction records. To get a true look at your portfolio, you're left with laborious pencilwork or keyboarding to merge these data with other holdings. Employers, thanks for helping us save money. Now, help us save time. Let our data go.

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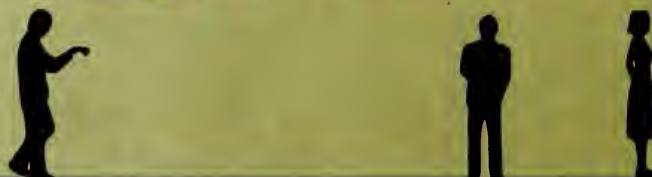
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DAY OF THE MID-CAPS



GENE G. MARCIAL

rates drop, one backs Caliper North Fork. gett's new cigarette smells a winner. And on has a big -phone market the Southeast

With the Fed on a mission to jump-start the economy, expect the small-to-mid-cap stocks to lead the market's next upswing. So argues Joe Battipaglia, Chairman of Investment Policy at Gruntal, who says the group performs best in an environment of declining interest rates. Each time the Fed has eased rates in years when the economy was in recession, the universe of low-cap stocks in the Russell 2000 usually outpaced the large-cap Russell 1000. So Battipaglia has overweighted his portfolio with small-and-mid-cap stocks in such areas as pharmaceuticals, financials, and technology.

Two of Battipaglia's top picks: Caliper Technologies (CALP), both a tech and a biotech play, and North Fork Bancorp. (NFB), a bank holding company serving New York and Connecticut.

Caliper's proprietary technology sets a new standard in biological research, says Battipaglia. It miniaturizes and integrates entire lab processes into a "lab chip" workstation that contains all the hardware and software to perform lab analyses. The technology is sold to big drugmakers to speed up research and cut its cost. Drugmakers such as Merck have acquired biotech to help them in their quest for new drugs. He expects Caliper to be in the black in 2002, earning 21¢ a share.

North Fork's stock has been on the rise in part because of its allure as a possible target in a consolidating industry. North Fork posted solid first-quarter results as deposits and loans grew briskly. The opening of more Manhattan branches, says Battipaglia, will spur growth. First-quarter deposits at its New York branches grew at an annualized 56% for existing branches. And its pending purchase of Commercial Bank of New York, he adds, should boost growth and its value. He expects earnings of \$1.92 in 2001 and \$2.20 in 2002.

BATTIPAGLIA'S MID-CAP PICKS

STOCK	PRICE MAY 16	52-WK. HI-LOW	12-MO. TARGET
CALIPER	25	71-12	58
NORTH FORK	27	27-15	33

Data: Bloomberg Financial Markets, Gruntal & Co.

FROM VECTOR: A NO-NICOTINE SMOKE

Even for nonsmokers, shares of Vector Group (VGR), which owns cigarette maker Liggett Group, may prove enticing. Its new cigarettes aren't typical: Made from genetically modified tobacco, they are virtually free of nicotine and have no nitrosamines, a potent carcinogen.

The no-nicotine and no-carcinogen combination will be a "powerful attraction" to smokers and could propel Vector's stock to new heights, accord-

ing to David Mills, who runs FleetBoston Financial's Mid-Cap Fund. "As value investors, we think Vector is undervalued based on its cash flow, dividend yield of 5.3%, earning power, and assets," says Mills. Even before the new cigarettes, to be launched in 2002, arrive on the market, the stock could climb to 40, says Mills. It has already taken a leap: from 10 in June, 2000, to 34 on May 16. Financier Carl Icahn recently bought a 13% stake.

By cutting out nicotine in the tobacco, the addictive power of the cigarettes is eliminated, says Bennett LeBow, chairman and CEO of Vector. The new cigarette "lights, tastes, and smokes just like conventional cigarettes," he says. Previous attempts by others to make nicotine-free cigarettes failed, he says, because of poor taste.

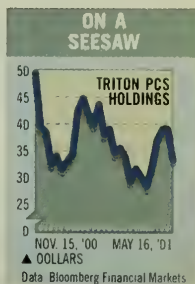
With the U.S. tobacco market estimated at 420 billion cigarettes a year, each 1% market share would equal 4.2 billion units. At a royalty rate of just 1¢ cent per cigarette, 1% utilization by other makers would represent \$42 million in royalty income alone for Vector, figures LeBow—excluding Vector's direct sales. The company posted sales of \$739 million and earnings of \$6.28 a share in 2000.

SOUTHERN VOICES ANSWER TRITON CALLS

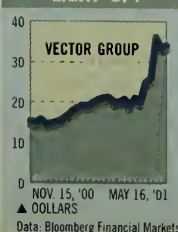
For a newcomer in the wireless telecom business, Triton PCS Holdings (TPCS) is doing surprisingly well. It went public in October, 1999, at 18 a share and hit 49 on Nov. 15, 2000. Since then, the stock has seesawed between 45 and 33, where it now trades. But most of the 14 analysts who follow Triton see it reaching 60 this year. And all of them give it either a buy or a strong buy rating.

One reason: This provider of wireless phone services in the Southeast—including Virginia, the Carolinas, and Georgia, covering 13 million potential customers—is ranked as the best operating company among 22 wireless carriers by Deutsche Bank Alex. Brown in its quarterly review in "penetration gain" (adding new customers), in revenue per subscriber, and in cash flow per subscriber. Triton's subscriber base has jumped from 195,201 customers last year to 446,401.

Among Triton's major shareholders: J.P. Morgan Chase, which owns 30% of the stock, and AT&T, which has a 17% stake. Triton has a co-branding pact with AT&T Wireless Services.



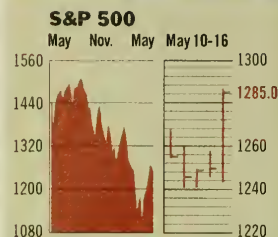
SET TO REALLY LIGHT UP?



BusinessWeek online

Read Gene Marcial's Inside Wall Street Online column Tuesday afternoons at www.businessweek.com/today.htm. And see him Fridays at 1:20 p.m. EST on CNNfn's *The Money Gang*.

Stocks



COMMENTARY

This week's market message: As long as there is hope for one more interest rate cut from the Federal Reserve, stocks should be O.K. The indexes stumbled going into the Fed's May 15 cut on fear it would be the last. Then the Fed hinted there will be another. The Dow rose 3.2% for the week, with United Technologies and Alcoa leading the way. Techs languished, again.

Data: Bloomberg Financial Markets
Bridge Information Systems, Inc.

U.S. MARKETS

	May 16	Week	Year to date	Last 12 months
S&P 500	1285.0	2.3	-2.7	-12.4
Dow Jones Industrials	11,215.9	3.2	4.0	2.6
Nasdaq Composite	2166.4	0.5	-12.3	-41.7
S&P MidCap 400	524.8	2.6	1.5	7.3
S&P SmallCap 600	226.5	1.8	3.1	9.3
Wilshire 5000	11,832.7	2.2	-2.8	-13.0

SECTORS

	May 16	Week	Year to date	Last 12 months
BusinessWeek 50*	907.2	2.2	-6.5	-26.7
BusinessWeek Info Tech 100**	504.3	-0.5	-10.8	-46.1
S&P/BARRA Growth	639.3	2.0	-7.0	-26.7
S&P/BARRA Value	645.6	2.7	1.5	4.1
S&P Energy	966.2	1.5	3.7	6.5
S&P Financials	159.9	3.4	-2.9	16.2
S&P REIT	88.0	0.9	0.0	9.3
S&P Transportation	748.7	3.1	7.3	24.2
S&P Utilities	331.5	0.1	-5.4	21.9
GSTI Internet	141.7	-0.7	-22.0	-70.8
PSE Technology	776.1	1.8	-4.7	-26.7

*Mar. 19, 1999=1000 **Feb. 7, 2000=1000

BEST-PERFORMING GROUPS

	Last month %	Last 12 months %
Office Equip. & Supplies	40.0	Engineering & Constr. 111.9
Specialty Appar. Retailers	35.5	Tobacco 89.8
Engineering & Constr.	29.3	Savings & Loans 81.4
Gold Mining	19.7	Homebuilding 77.3
Entertainment	18.7	Food Wholesalers 59.0

GLOBAL MARKETS

	May 16	Week	Year to date
S&P Euro Plus (U.S. Dollar)	1247.8	1.2	-1.1
London (FT-SE 100)	5884.0	-0.2	-
Paris (CAC 40)	5522.7	0.6	-
Frankfurt (DAX)	6148.4	1.4	-
Tokyo (NIKKEI 225)	13,694.3	-2.8	-
Hong Kong (Hang Seng)	13,336.0	-1.8	-1
Toronto (TSE 300)	8146.0	0.9	-
Mexico City (IPC)	6034.0	-1.2	-

FUNDAMENTALS

	May 15	Wk. ago
S&P 500 Dividend Yield	1.26%	1.25%
S&P 500 P/E Ratio (Trailing 12 mos.)	28.1	28.1
S&P 500 P/E Ratio (Next 12 mos.)*	21.9	22.1
First Call Earnings Revision*	-3.72%	-4.29%

*First Call Corp.

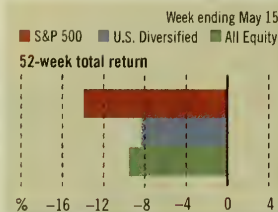
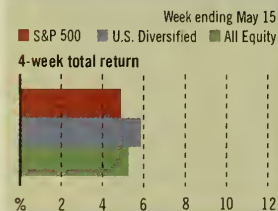
TECHNICAL INDICATORS

	May 15	Wk. ago
S&P 500 200-day average	1338.0	1343.1
Stocks above 200-day average	68.0%	66.0%
Options: Put/call ratio	0.67	0.61
Insiders: Vickers Sell/buy ratio	2.51	2.71

WORST-PERFORMING GROUPS

	Last month %	Last 12 months %
Defense Electronics	-6.0	Communications Equip. 111.9
Natural Gas	-3.7	Metal & Glass Containers 89.8
Hospital Management	-1.6	Long-Dist. Telecomm. 81.4
Long-Dist. Telecomm.	-1.1	Semiconductors 77.3
Airlines	-0.2	Instrumentation 59.0

Mutual Funds



Data: Standard & Poor's

EQUITY FUND CATEGORIES

4-week total return	%	52-week total return	%
Leaders		Leaders	
Precious Metals	10.9	Financial	26.9
Small-cap Growth	9.1	Small-cap Value	19.4
Technology	8.5	Mid-cap Value	17.5
Japan	7.9	Natural Resources	16.9
Laggards		Laggards	
Utilities	0.0	Technology	-44.9
Latin America	0.1	Communications	-43.5
International Hybrid	2.1	Japan	-30.5
Health	2.3	Diversified Pacific/Asia	-26.4

EQUITY FUNDS

4-week total return	%	52-week total return	%
Leaders		Leaders	
American Heritage	40.0	Schroder Ultra	98.0
Apex Mid Cap Growth	23.7	Potomac Internet Short	96.5
Jundt U.S. Emerg. Gr. A	22.5	CGM Focus	85.2
Van Wagoner Technology	18.8	Burnham Financial Svcs. A	71.3
Laggards		Laggards	
ProFunds UltraShort OTC	-19.7	ProFunds UltraOTC Inv.	-84.9
Rydex Dynamic Vent. 100	-19.4	Jacob Internet	-76.9
Potomac Internet Short	-12.1	Potomac Internet Plus	-74.8
Prudent Bear	-10.5	ING Internet A	-73.1

Interest Rates

KEY RATES

	May 16	Week ago
MONEY MARKET FUNDS	4.41%	4.54%
90-DAY TREASURY BILLS	3.56	3.72
1-YEAR TREASURY BILLS	3.66	3.69
10-YEAR TREASURY NOTES	5.46	5.20
30-YEAR TREASURY BONDS	5.86	5.67
30-YEAR FIXED MORTGAGE†	7.21	7.01

†BancQuote, Inc.

BLOOMBERG MUNI YIELD EQUIVALENTS

Taxable equivalent yields on AAA-rated, tax-exempt bonds, assuming a 31% federal tax rate.

	10-yr. bond
GENERAL OBLIGATIONS	4.47%
TAXABLE EQUIVALENT	6.48
INSURED REVENUE BONDS	4.60
TAXABLE EQUIVALENT	6.67

THE WEEK AHEAD

NEW SINGLE-FAMILY HOME SALES Thursday, May 24, 10 a.m. EDT ▶ New homes in April probably sold at an annual rate of 975,000, down sharply from the record rate of 1.02 million in March. That's according to the median forecast of economists surveyed by Standard & Poor's MMS, a unit of The McGraw-Hill Companies.

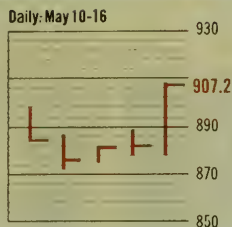
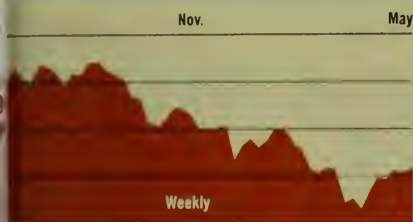
GROSS DOMESTIC PRODUCT (REVISION) Friday, May 25, 8:30 a.m. EDT ▶ The Commerce Dept.'s second look at economic growth

in the first quarter is expected to show that real GDP grew at a 1.7% annual rate, down from the advanced estimate of 2% reported in April. Inventories, which shrank for the first time since 1991, will likely be revised lower, as will consumer spending. Aftertax corporate profits likely fell 10.5% in the first quarter. Second-quarter real GDP is forecasted to grow at just a 1% annual rate.

DURABLE GOODS ORDERS Friday, May 25, 8:30 a.m. EDT ▶ New orders for durable

goods probably declined 2% in April after advancing 3% in March. The increase was driven by orders for ships and tanks. Excluding the transportation component, March durable goods orders were down 1.8%.

EXISTING HOME SALES Friday, May 25, 8:30 a.m. EDT ▶ Existing homes likely to rise at an annual rate of 5.25 million in April based on the S&P MMS survey. In March, home sales jumped 4.8%, to a 5.1 million annual rate.

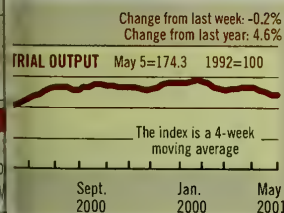


ch-heavy Nasdaq edged up 0.5% last week, the more diverse BW 50 gained 2.2%. Standouts wereessor Paychex, up 11.9%, and retailer Bed, Bath & Beyond, up 11.6%. Both should do well in a strongerilips Petroleum climbed 7.8% in anticipation of higher refining margins. But natural gas company El1% amid scrutiny in Washington and Sacramento over its conduct in the California energy mess.

COMPANY PERFORMANCE

Company	% change		Rank	Company	% change	
	Week	Since 3/1/01			Week	Since 3/1/01
International	5.8	2.0	26	Verizon Communications	2.0	13.3
Exxon Petroleum	4.1	4.2	27	Alza	3.1	26.3
	-0.6	18.6	28	Citigroup	4.7	6.5
	-0.2	15.5	29	Sun Microsystems	-3.1	-6.9
Materials	6.0	19.3	30	Merck	1.0	-2.1
Bank Financial	6.2	12.3	31	El Paso	-7.1	-12.9
Shell Petroleum	3.6	27.8	32	Altera	1.5	6.6
	1.9	3.2	33	Marsh & McLennan	5.0	-0.5
3M	-0.4	9.1	34	Household International	3.9	17.5
	-3.9	-23.3	35	Chevron	-0.2	9.7
Brothers Holdings	2.9	15.7	36	SBC Communications	6.3	-1.3
	1.6	-2.9	37	Mercury Interactive	3.7	13.8
	-6.4	-23.2	38	AOL Time Warner	2.0	20.5
Laboratories	3.6	-4.1	39	Washington Mutual	6.4	8.3
Bank Financial	3.8	-0.6	40	General Dynamics	2.4	19.3
Technology	-5.5	9.2	41	Comcast	-0.7	-0.1
	2.0	6.5	42	Morgan Stanley Dean Witter	6.2	8.6
Exxon Hess	3.2	21.3	43	Tellabs	3.6	-11.2
Energy	0.7	11.6	44	Exxon Mobil	-0.2	10.0
Telecommunications	7.0	-16.2	45	Scientific-Atlanta	0.2	29.0
Bank Financial	4.5	19.4	46	U.S. Bancorp	2.8	-5.6
Petroleum	7.8	19.9	47	Paychex	11.9	-1.4
Devices	1.8	14.5	48	Merrill Lynch	6.6	16.6
Resources	4.6	8.3	49	Bed Bath & Beyond	11.6	16.1
Health	1.9	4.9	50	Texas Instruments	2.5	18.8

Production Index



on index declined once again in the latest calculation of the four-week moving average slipped to 174.4 from 174.7 in the week after seasonal adjustments, steel led the ride-oil refining and coal production also truck assemblies, lumber, and rail-freight all up for the week. Electric power was also East Coast was hit by unseasonably hot

Each of the index components is at www.businessweek.com
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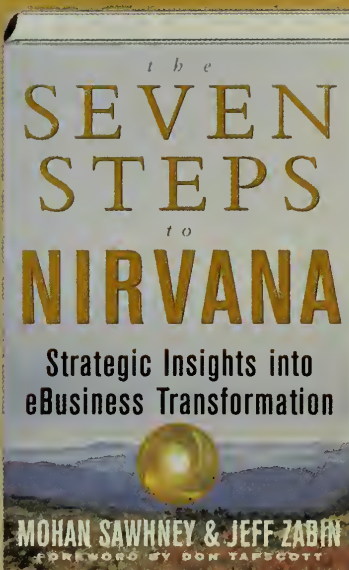
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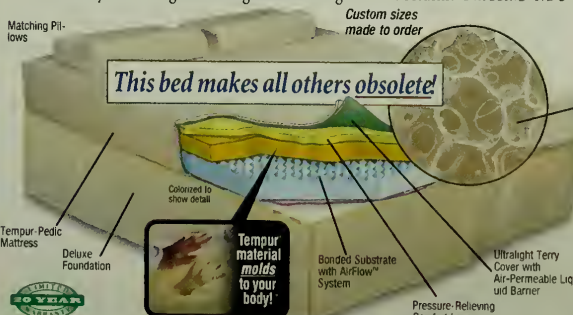
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BusinessWeek (ISSN 0007-7135) published weekly, except for one week in January and one August, by The McGraw-Hill Companies, Inc. Executive, Editorial, Circulation, and Advertising Offices: 1221 Avenue of the Americas, New York, N.Y. 10020. U.S. subscriber rate \$54.95/year; Canada, \$69.95/year. Periodicals postage paid at New York, N.Y., and at additional mailing offices. Postage paid at Montreal, P.Q. Canada Post International Publications Mail Product Sales Agreement No. 2461. Postmaster: Send address changes to BusinessWeek, P.O. Box 430, Hightstown, N.J. 08520.



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A RISKY TILT IN FOREIGN POLICY

Without much public debate, the Bush Administration is making a dramatic shift in U.S. foreign policy, moving America's security focus away from Europe and Russia to Asia and China. A new missile defense system is only part of a larger policy change to address China's increased military might. Discussions are under way in Washington to retarget strategic missiles, redeploy Trident submarines, remilitarize Japan, and ally with India. No one is yet using the word "containment," but a look at the map shows that the U.S. is clearly organizing a Pan-Asian effort that amounts to just that. Washington policymakers should realize that any attempt to replicate America's cold war policy success against the Soviet Union with China is fraught with danger (page 52).

China today is not the Soviet Union. In the 1980s, the Soviet Union was a failed totalitarian dictatorship where the military absorbed all available resources and everyone worked for the state. The economy was stagnant. People were demoralized. The threat of Star Wars convinced the military it couldn't compete with the U.S. and helped crack the Soviet system.

China, by contrast, has a more open, increasingly capitalist, and thriving economy. The Chinese military budget is modest. There are 55,000 Chinese students in U.S. colleges. People in cities plug into the Internet. The legitimacy of Beijing's leaders rests not on military might but on delivering a higher standard of living. Because they have so far delivered, there is strong support for them, although there is criticism against corruption and religious intolerance. Yes, there are still plenty of human rights abuses, but the goal is to get

China to follow South Korea and Taiwan to democracy.

The U.S. must counter any Chinese military threats to take over democratic Taiwan and control the South China Sea. That could require an expanded naval and air force presence in the region. But a new alliance comprising the U.S., Japan, Korea, and India that seeks to contain China could set off an arms race in Asia, thereby destabilizing it.

For one thing, it would require Japan to change its constitution, written by U.S. occupation forces, which prohibits it from having a standing army and renounces war as an instrument of policy. This would alarm not only Beijing but Seoul, Manila, Jakarta, Singapore, and every other capital overrun by Japanese troops during World War II. China and Korea especially believe that Japan has never shown proper remorse for its actions during the war. They complain bitterly about Japanese textbooks that depict Japan as victim, not aggressor, and politicians who deny the Rape of Nanjing or the enslavement of Korean women. Japan may also be in secular decline. It cannot revitalize its economy. Its aging population isn't being replaced, thanks to low birth rates and little immigration. It hardly seems wise to replace Japan's fading economic role with that of Asian policeman.

There is one key question facing the U.S. in Asia today: How do you push China toward market democracy while curbing its irredentist impulses? To judge by the past 50 years, globalization trumps military containment as the more powerful answer. At the very least, this major shift in U.S. foreign policy deserves a full public airing.

GREEN BUSINESS IS GOOD BUSINESS

The U.S. is facing a wide range of problems—the California electricity shortage, high gasoline prices, growing dependence on overseas OPEC oil, lack of refining capacity—that fall under the overall umbrella of “energy crisis.” As we contemplate President Bush's energy proposal, we would do well to keep in mind two things. First, the market is already responding to higher energy prices, and to the degree that the crisis is one of supply, it is well on its way to being solved. At the same time, both the Administration and its environmental critics are engaging in caricature in attacking one another while refusing to accept what is obvious—a practical energy package should include incentives to both boost production and increase conservation (page 34).

The current energy debate was not helped when Vice-President Dick Cheney, usually a savvy pol, launched a misguided public attack on energy conservation. No one, except for a handful of eco-extremists, believes that conservation is the only answer to the energy crisis. But few believe that conservation plays no role either. It is up to Congress to negotiate a balance in the weeks ahead.

We think part of the problem is cultural. Many Bush officials see energy conservationists as antigrowth. To Americans brought up on the frontier ethic of unlimited progress, opportunity, and growth, the concept of limits is apostasy. Through the push for government regulations to set efficiency standards for appliances or mileage standards for cars, and some people see greens as antibusiness as well.

Their anger, however, is misdirected. Conservationists today are increasingly pro-growth and pro-market. They focus on working with corporations such as Gap, Ford Motor, Pfizer, and Novartis in developing new technologies to save energy. They support market solutions, such as trading pollution credits, to help keep the air clean.

In fact, the market is hard at work solving the energy crisis. Some 90,000 megawatts of generating capacity is already under construction. Gas companies are putting down hundreds of miles of pipeline. And drilling is up sharply as well.

Washington can help. A package that focuses on both energy production and conservation won't threaten American values or its way of life.



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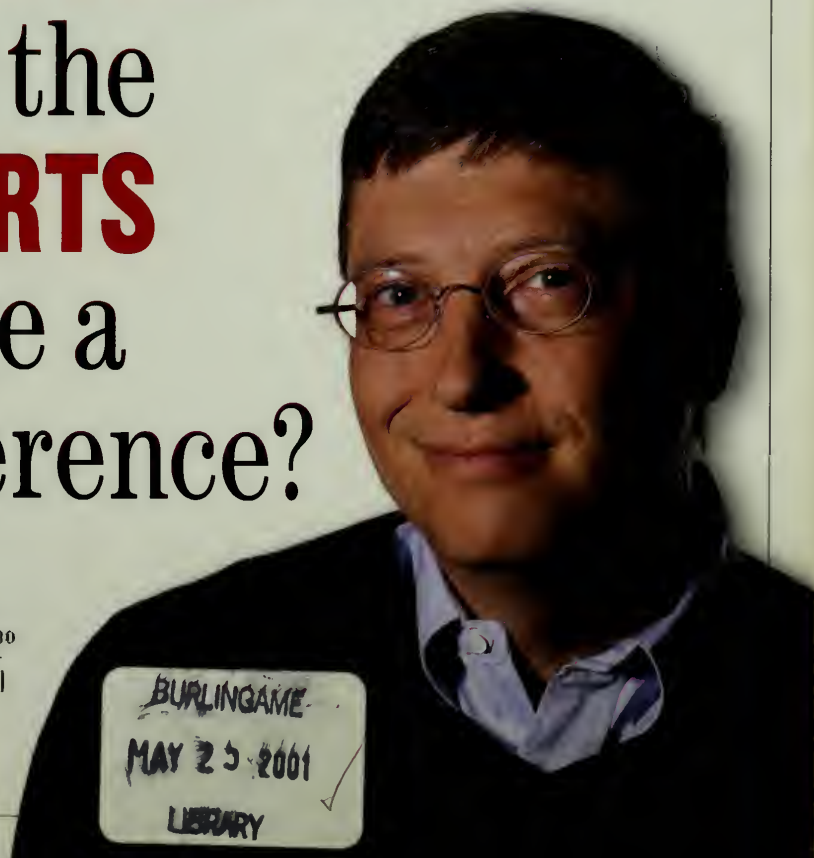
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MICROSOFT

How it became
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Will the
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make a
difference?

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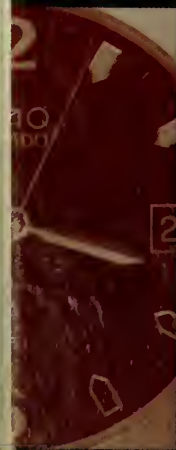
Because he has new Office XP, today he feels complete. Today, he doesn't have to log on to different e-mail accounts, trying to recall secret passwords he made a bit too secret. He will open Outlook® and find messages to jeffrey, jee, jeff19422, and even the mysterious jammasterjday, all in one place. So many faces for just one simple guy.

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COVER STORY

MICROSOFT

It's about to launch the most fearsome array of new products in its history, and it seems more emboldened than ever page 74

BusinessWeek

JUNE 4, 2001



HORSE RACING
Handicapping
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Merrill page

Cover Story

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And not only that, but the software Goliath is stronger than ever. Will the courts make a difference? If antitrust settlement talks are a possibility, as some expect, the company will be negotiating with a friendlier Administration. Meanwhile, it is adding \$1 billion a month to the \$30 billion it has salted away in the bank. No wonder CEO Steve Ballmer has proclaimed: "We're off the ropes." For cash-strapped rivals, that's a nightmare come true

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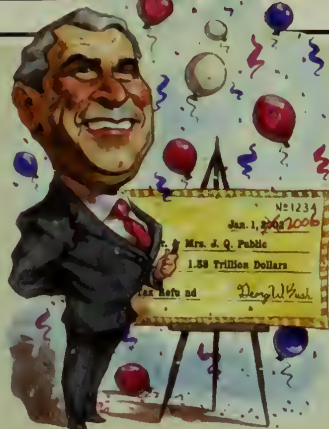
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A recovery in the second half of the year is still likely, says Nancy Tengler of Freemont Funds



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DSL and cable have won the early bandwidth battles, but a new, relatively low-cost technologies could soon come on strong



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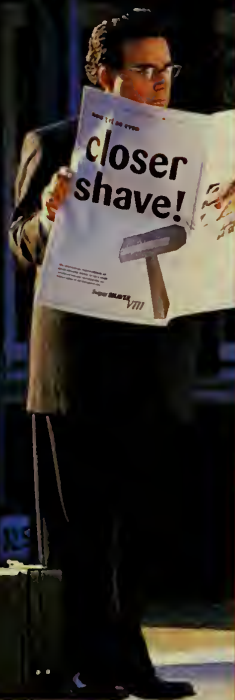
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Up Front

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NO TALKING



DITCH THE CELL—OR OCCUPY ONE

WHEN NEW YORK'S WEEKEND BEACHGOERS DRIVE OUT TO THE Hamptons this year, they're going to have to give up a staple: cell phones to the ear while at the wheel. The two counties linking the city to the beach have enacted cell phone bans. The whole of New York State may be next—and become the first in the nation to do so. Governor George Pataki hopes to have draft laws on his desk by summer. Says Judy Jacobs, a Nassau County legislator: "We want two hands on the wheel and two eyes on the road."

That desire may soon be nationwide. On May 22, legislators in both houses of Congress introduced laws to curb cell phone use while driving. While the feds work out the details, 40 states are also considering bans, up from 27 last year. More than a dozen municipalities across the nation already have them.

Although a recent American Automobile Assn. study showed that cell phones cause only 1.5% of auto accidents, a 1997 *New England Journal of Medicine* report found that cell-phone distractions quadrupled the risk of collision—a rate equal to intoxication. The wireless industry had long opposed bans, but providers like Verizon are now softening. They back them as long as they're phased in and legalize hands-free accessories—at about \$20 apiece.

Brian P. Murphy

THE LIST DEAD, YES—BUT STILL HOT

Deceased celebrities are now the most sought-after—and controversial—figures in advertising. Digital technology has allowed Fred Astaire to dance with a *Dirt Devil*. Now it lets you watch Martin Luther King Jr. having "a dream" about communication networks.

ALCATEL TV, print ads feature King's "I Have a Dream" speech (March), Lou Gehrig's 1939 farewell speech (May)

MIKIMOTO PEARLS Print ads in *Elle* and *InStyle* magazines feature Marilyn Monroe (summer)

APPLE COMPUTER L.A. mural to show Wilt Chamberlain as part of its "Think Different" campaign (fall)

HAMILTON WATCHES Billboard, print ads depict James Dean (March)

Data: Commercial Alert/CMG Worldwide



PERRIER Billboards show comedian Marty Feldman's face (February)

NEWS FLASH On May 19, the 57 grads of Southern Methodist University's Cox School of Business made what officials believe is the largest-ever donation by Executive MBAs (mainly senior Texas execs taking weekend courses). Together they pledged \$1 million. Typically, grad gifts average \$20,000 to \$50,000.

BON APPETIT

WHERE'S THE BEEF? EVERYWHERE

IT'S NOT EASY EATING GREEN. After years of eating French fries from McDonald's without thinking twice, vegetarians were jolted to learn that the chain flavors its potatoes with beef extract. Caveat emptor: Many other seemingly meat-free foods also contain animal products.

Kellogg's Frosted Mini-Wheats, for one. Listed among its ingredients is gelatin, a gummy substance rendered from cattle carcasses. Gelatin is also used to coat gel-cap pills—and is in marshmallows, sour cream, Skittles and other candies—and, of course, Jell-O.

When asked, many restaurants admit that they, too, include animal ingredients where you might not expect them. Church's Chicken and Denny's also flavor their fries with beef fat. The guacamole

at Applebee's uses gelatin and its vegetable roll-up tortilla may contain lard (pig fat). Pizza Hut only recently eliminated chicken broth from its pizza sauce but still uses it in the white sauce in pasta dishes. "You almost need



IMPULSE It's hard to avoid animal parts

degree in food science today, laments Rabbi Jeffrey R. Popoport, who advises on the kosher diet, which forbids meat and dairy in the same meal. For those avoiding meat, that's troubling food thought. Michael A.

FALLING AXES

PINK SLIPS WITH A SILVER LINING

IF LAYOFFS CAN HAVE HAPPY endings, this may be one case: Cisco Systems, which dismissed 6,000 full-time workers in April, got creative about its severance package—and decided to help charity. The San Jose (Calif.) company is allowing the pink-slipped who agree to work for a local nonprofit organization for a year to collect one-third of their salaries, plus benefits and stock options—and be first in line for rehiring once the economy recovers.

Nonprofits, of course, are delighted. "It's going to allow

us to move ahead faster on technology projects," says Dave Sandretto, director of the food bank for Santa Cruz and San Mateo counties. He's interviewing Cisco candidates for five accounting and computer-related positions.

So far, 150 ex-Ciscoans are participating. The company is also offering workers nine months' more pay than usual to exercise their currently unexercised stock options.

Carol Cone, who runs Boston-based strategic marketing firm Cone Inc., says

Cisco is wisely maintaining ties to its talent pool while helping tech-challenged nonprofits: "It's really a fascinating and very visionary approach to a layoff." Hear that, Human Resources? Joan C.





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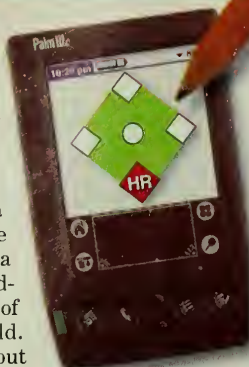
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Up Front

PRODUCT PEEK

HARDBALL SOFTWARE

FOR AT LEAST 100 years, it has been done this way: hunched over a scorecard in the bleachers, gripping a stubby pencil, recording the movements of players on the field. But now, just get out your Palm and stylus. The leading PDA maker is



introducing a baseball-scorekeeping application this month at San Francisco's Pacific Bell Park. Fans will be able to download an electronic scorecard, team stats, and base-

ball trivia from two or three beaming stations throughout the park. It requires software that takes about 20 seconds to receive. "This can work for a variety of our fans—from the not-so-serious ones who haven't kept score before to the guy who comes out to the ballpark once a homestand," says Jason Pearl, the Giants' vice-president for corporate sponsorship.

Stats such as batting averages and the earned-run average of the ace relief pitcher can be updated as the game goes on. It also logs such details as the precise length of the game.

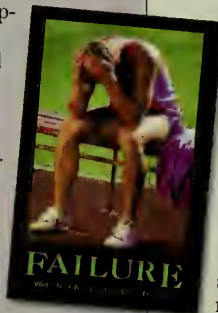
But won't people miss the traditional way? "I suspect a large number of people with the most expensive Palms in the world will prefer the old method," says Paul Dickson, author of *The Joy of Keeping Score: How Scoring the Game Has Influenced and Enhanced the History of Baseball*. Palm hopes to win over skeptics with free software for 60 to 90 days. After that, says Keith Bruce, director of FCB Worldwide Sports Marketing, which is handling the rollout, the software will carry an as-yet-undetermined charge. Palm has no plans for other ballparks yet. But perhaps someday the old song will go, "Take Your Palm to the Ball game..." *Mark Hyman*

AS THE DOWNTURN TURNS

FOR DALLAS-BASED GLOOM-and-doom e-tailer Despair.com, bad news is good. Despair sells T-shirts, posters ("Failure—When Your Best Just Isn't Good Enough") and other paraphernalia as gag gifts or personal pick-me-ups for failed dot-commers or the similarly self-loathing.

Its best-seller is a calendar: *The Official Requiem for the Dot-com Dream* (\$14.95), with monthly "demotivational" topics such as bitterness and delusions, as well as tech anniversaries (Jan. 7, 1980: Space Invaders debuts on Atari). Its Pessimist's Mug (\$9.95) indicates when the glass is half empty. The private company logged 1.3 million page views in April, double a year ago, and reported revenue of \$1 million in 2000.

Even if the economy recovers soon, says co-founder Justin Sewell, "we plan to stick with our model of profiting from misery, at least until someone solves the problem of human unhappiness." Proving, of course, that it pays to have a sense of humor about it. *Olga Kharif*



DRAWN & QUARTERED



WALL STREET WOMEN

GET EVEN BY GETTING ON THE NET

IT'S AN OLD STORY ON WALL Street: discrimination against women. Now there's a new way to deal with it. A woman who alleges being targeted herself has started a site, www.womenonwall.com, for women frustrated with careers in a male-dominated industry.

Amy Segal, 34, filed a \$150 million gender discrimination suit in April against J.P. Morgan Securities for her inclusion in 800 layoffs in 1998. She claims less qualified men kept their jobs; Morgan "vigorously denies" discrimination. "I had no one to talk to, and I wanted to

get a dialogue going," she says. "More women are coming forward, but I still don't think it's a lot."

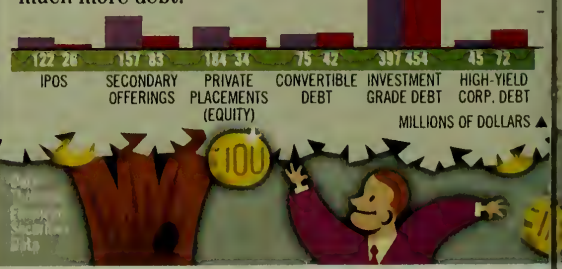
To encourage them, the site links to the Equal Employment Opportunity Commission, which explains how to file a discrimination charge, and to the National Organization for Women. There's also a resources page and a discussion board. Since its May 9 launch, women have been swapping stories and offering encouragement—part of a New Age network taking on the Old Boys Network. *Mara Der Hovanesian*



THE BIG PICTURE

MORE DEBT, LESS EQUITY

The downturn means fewer companies are going to equity markets in search of capital. Instead, they're issuing much more debt.



FOOTNOTES Expatriate employees who quit jobs upon return to U.S.: **49%**; who are critical of transition services: **45%**

Any business insurer knows the importance of risk.
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HOW TO END THE NUMBERS GAME

"The numbers game" (Cover Story, May 14) was a great article. It's hard enough to keep the financial people honest when there is just one set of rules. Having multiple standards makes it that much more difficult. The Securities & Exchange Commission should require that the generally accepted accounting principles (GAAP) numbers should be the first and most prominent set of figures in any publicly disseminated disclosure. This at least gives us a common starting point.

However, one of your red flags is wrong. "Sales are booked before payments are received" is the textbook definition of credit sales, which is the basis of accounts receivable. A better warning would be: "Sales are booked before merchandise is shipped" or "Sales are booked before orders are received." These two practices indicate carelessness at best, but more likely they are intended to deceive and are indicators of fraud.

Lewis Hirschfeld
New York, N.Y.

"The numbers game" illustrates what happens when the fox guards the henhouse and when stockholders' unrealistic, zero-defects, short-term expectations are coupled with executives' short-term compensation packages that actually encourage number-juggling. Directors are executives of other companies who condone this behavior. The fix? Term limits should be imposed on a company's operating officers, and the variable portion of executive compensation should be vested two to four years after depart-

ture. This would ensure the long-term interest of owners of going concern.
Murray Hawthorne
Greenwood, Ind.

WHY CAPITAL GAINS INCOME IS IN A CLASS BY ITSELF

It is inaccurate to equate capital-gains income, much of which can be earned years earlier than reported, with income consisting primarily of salaries, wages, dividends, and interest, which is earned and reported in the same year ("How the super-rich got lucky out twice," News Analysis & Commentary, May 14). Yet this is what the Internal Revenue Service have done to identify the "super-elite" and to claim that they are inequitably taxed less than others.

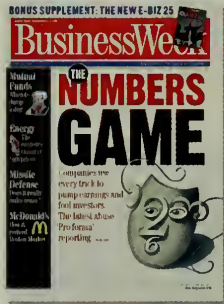
Merwyn R. Macdonald
Pittsburgh, Pa.

In 1995, when the average super-rich individual made \$50 million, he paid 11.1 million at the 30% rate. In 1998, the average super-rich taxpayer made \$110 million and the individual rate did indeed drop. The 22% rate yielded \$24.2 million in taxes; a 61% increase. The important point, which you failed to mention, is that lowering the capital-gains tax rate caused an increase in tax revenue. That's just what the supporters said would happen.

Robert W. Minetti
Marietta, Ga.

DON'T BLAME AMERICAN AIRLINES FOR TRYING TO COMPETE

[Dan Carney's commentary] on May 14. J. Thomas Marten's dismissal of their titrusion action brought by the Justice



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CORRECTIONS & CLARIFICATIONS

In "Funds just aren't having any fun" (Finance, May 14), Financial Research Corp. supplied incorrect data about Eaton Vance funds flows: The number in an accompanying table showed \$937 million in outflows for the first quarter ended Mar. 31. In fact, the company had \$792 million in positive inflows.

Dept. against American Airlines Inc. missed one of the central points of the debate generated by the case and ignored decades of antitrust law ("Predatory Pricing: Cleared for takeoff," News: Analysis & Commentary, May 14). The court properly rejected the Justice Dept.'s proposed new legal standard because it would have branded vigorous competition illegal, and in so doing, chill the very conduct the antitrust laws are meant to protect. Judge Marten applied long-accepted antitrust principles governing price competition—principles that courts have repeatedly employed to distinguish between predatory pricing and the vigorous price competition the antitrust laws encourage.

The Justice Dept. was blaming American for competing. There was no dispute that it was the new entrants, not American, who set the prices. American did nothing more than match those prices and add capacity to ensure seats were available at the new, lower price levels. If the Justice Dept. believes that the antitrust laws need updating to reflect the "New Economy" of which Mr. Carney writes, then it should pursue a legislative remedy open to public debate and consideration.

Robert E. Cooper
Partner, Gibson, Dunn & Crutcher
Trial Counsel for
American Airlines Inc.
Washington

CHINA SHOULD WELCOME DEFENSE SPENDING

It would be foolish for any rogue state to attack the U.S. with a ballistic missile ("Shield—or red flag?" International Business, May 14, and "Missile Defense: A tricky course," Editorials, May 14). Delivery of a weapon in a container ship, rental truck, or other means would accomplish whatever deranged objective the attacker had in mind, with much less cost, and with reduced odds of being detected.

The U.S. pursuit of ballistic missiles has less to do with legitimate defense

needs than the fact that once upon a time we started a defense program (strategic defense initiative), and 18 years later we still can't figure out how to stop spending money on it. Rather than fearing our pursuit of ballistic missiles, China should applaud it, since it drains resources from investments that might solve real problems and make us more competitive economically.

Colonel Harvey R. Greenberg (Ret.)
U.S. Air Force
Westford, Mass.

CONSERVATION KEEPS AMERICA COMPETITIVE

The Vice-President's recent dismissal of energy efficiency as a meaningless "private virtue" violates the very core of America's belief in the power of individual initiative and self-sufficiency ("Don't write off energy conservation, Mr. Cheney," News: Analysis & Commentary, May 14). The U.S. economy leads the world because we have continuously reduced the amount of energy required to produce each unit of economic growth. Historical growth has been achieved through equal investments in energy efficiency and new energy sources.

Ren Anderson
Broomfield, Colo.

Paul Raeburn's commentary misses the political point: Real men don't conserve energy. That is, white men who are the mainstay of Republican support. They smoke, don't obey the speed limit, and don't fasten their seat belts, either. Conservation is for sissies. That's the message. It doesn't matter that Dick Cheney and George W. Bush are oil-men. Karl Rove is calling this shot.

Daniel E. Whitney
Arlington, Mass.

ADVICE TO THE DOWNSIZED —FROM A VETERAN

I tried very hard to feel some degree of sympathy with "Sam" over the loss of his \$17 million nest egg, now reduced to a measly \$300,000. ("The harder they fall," e-biz, May 14). Empathy, maybe; sympathy, not: \$300,000 is nothing to sneeze at. It has taken me almost 25 years to build up a next egg of that size, with 401(k) and individual retirement accounts in the Old Economy. And for perspective, try being downsized every three to four years. I and most of my cohorts have had the same experience in a depressing cycle as companies reengineered, downsized, or sim-

ply disappeared. Just keep that résumé updated and have the names of friendly recruiters handy. You never know.

Joel T. Shertok
Newark, D.

THE GREEDY GIANTS OF HEALTH CARE

I thought giants were friendly and loved ("Leonard the giant killer?" People, May 14). WellPoint Health Networks Inc. CEO Leonard D. Schaeffer cuts the time mothers can stay in the hospital after deliveries. He raises consumer rates while reducing doctor reimbursement. He will save Blue Cross money on antihistamine prescriptions but not return a penny of savings to consumers. He may be a giant to himself and WellPoint but not to those who support, subscribe, and do his work.

Robert Millhouse M.
Thousand Oaks, Cal.

Leonard Schaeffer asserts that moving allergy medications such as Claritin, Allegra, and Zyrtec from prescription to over-the-counter status would save his company \$90 million. I'm sure it would, and the savings would come not out of the drug companies' pockets but out of ours.

Suzanne Ogden
Carrollton, Tex.

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BJC-85 Bubble Jet Printer.

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BJC-50 Bubble Jet Printer.

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Simon & Schuster • 751pp • \$35

THE FOUNDING FATHER NOBODY LOVED

Near the end of the Revolution, John Adams tried to explain in a London newspaper why Americans were so passionate about their independence. "Men are governed by Words," he wrote. "Their passions are inflamed by Words." In David McCullough's majestic biography of Adams, the second U.S. President, one has a strong sense that it was literary ingenuity as much as a rich perceptive intelligence that defined his career. That is an interesting proposition and a lively way to approach a founder as feisty as he is underappreciated.

A man of unquestioned integrity, Adams succeeded the larger-than-life George Washington and spent his one-term Presidency as an isolated and harassed executive. He inherited an unstable world and was forced to mediate his countrymen's anguished responses to Anglo-French war. The Jeffersonian opposition imagined Adams a pro-British monarchist, while frenzied Federalists, his own party, proposed war with France's revolutionaries out of a fear that they were stirring up America's masses. Adams kept the peace and received no credit for it.

McCullough, the celebrated biographer of Middle American Harry Truman, portrays Adams as an indelicate Yankee, profoundly self-centered, garrulous, and utterly sincere. The author spends much time on Adams' youth, the evolution of his revolutionary ideas, and his years abroad as a diplomat. Somewhat less time is given to his Presidency and later years.

It is hard to rank McCullough's epic of Adams against historian John Ferling's superb, authoritative *John Adams*, now a decade old. While McCullough's knowledge of early American political culture cannot compare with Ferling's, his storytelling ability is without peer. McCullough highlights the Adams marriage more, and to good effect. To his

torians it will be clear that he draws on far fewer sources than his massive bibliography suggests. But he succeeds notably in sustaining enthusiasm across 751 pages, taking a wise and soulful man who was inept at courting popular opinion and lionizing him.

A big chunk of the book is a distillation of Adams' diary. McCullough adds color to complete a visual, satisfying picture. The reader learns precisely what it was like to be aboard the frigate *Boston* on the distinguished diplomat's first voyage to Europe in 1778, when he was publicizing the American cause. We are privy to the weather, the reading list, "the reek of burning sea-coal and the stench of stagnant water below-decks," in McCullough's words, and the "hot work" of capturing a heavily armed British merchant ship. We also get Adams' quintessentially self-serving thoughts: "I am constantly giving hints to the captain concerning order, economy, and regularity."

The expressive diarist was also present when Benjamin Franklin and Voltaire, both heroic figures, met between acts at the Comédie Française in Paris. As the two cult icons embraced in the French manner, Adams, a great scrutinizer of others, described the old Frenchman's "sparkling vitality...still the poet's eyes with a fine frenzy rolling." Yet Adams conveys, too, how immune he is to the spark of charisma. Charismatic is what he is not.

Franklin was the homespun wit, Jefferson the far-reaching pen, Adams the sober prophet behind the revolutionary moment. Adams grumbled about his destiny, which he foresaw, to be remembered only as stodgy and ungracious, unloved by the masses despite the clarity of his philosophic resolve.

McCullough makes a sprightly effort to give Adams his due, and to show him affable, as well as insightful, he could

Equally appealing is the importance Abigail Adams to her husband's life. He calls her "my best, dearest, wisest, wisest friend in this world" and does not exaggerate. For a man who was, McCullough writes, "almost incapable of staying out of an argument," there was no argument that Abigail could not deliberate along with him.

In his effort to capture the poetry of Adams' long life, McCullough perhaps loves his subject too well and displays a few patriotic blind spots. With phrases such as: "With his overriding sense of duty, Adams..." The author is prone to taking his subject's words at face value, as if people always reveal who they are without indirection. Adams throws himself into farming with the same zeal he applies to government. He is too clear-cut.

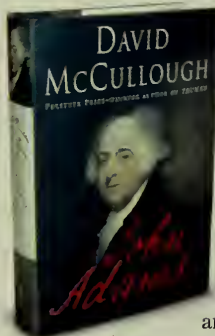
One extravagant assumption is disturbing enough that it ought to be righted: Before Jefferson died—just hours after Jefferson died—on July 4, 1826, 50-year-old Adams was recorded as saying, "Jefferson survives." Too good to be true. The two contentious patriarchs "conspired" alike to make their final exit on the day of national jubilee—the 50th Fourth of July—Adams was given these immortal and sublime "last words."

McCullough, like most historians, never questions them, but a dip into the archive reveals that while Adams may say something about Jefferson, the words were, according to members of the Adams family, "indistinctly uttered."

Still, McCullough's gripping biography reveals Adams to be as quotable as the better known founders, telling his future President John Quincy Adams: "A taste for literature and a turn for business, united in the same person, never fails to make a great man." It was a greatness measured more by sight than by mere popularity.

BY ANDREW BURSTEIN

Burstein is professor of history at the University of Tulsa and author of *America's Jubilee: How in 1826 Generation Remembered 50 Years of Independence*.



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The BusinessWeek Best-Seller List

HARDCOVER BUSINESS BOOKS			PAPERBACK BUSINESS BOOKS		
	LAST MONTH	MONTHS ON LIST		LAST MONTH	MONTHS ON LIST
1 WHO MOVED MY CHEESE? by Spencer Johnson, M.D. (Putnam • \$19.95) <i>Learning to accept change.</i>	1	28	1 RICH DAD, POOR DAD by Robert T. Kiyosaki, with Sharon L. Lechter, CPA (Warner • \$15.95) <i>Teach your kids the rules of money that the rich play by.</i>	1	2
2 FAST FOOD NATION by Eric Schlosser (Houghton Mifflin • \$25) <i>The bad news on burgers.</i>	2	2	2 GETTING TO YES by Roger Fisher, William Ury, and Bruce Patton (Penguin • \$14) <i>A Harvard team's step-by-step guide to conflict resolution.</i>	7	7
3 FISH! by Stephen C. Lundin, PhD, Harry Paul, and John Christensen (Hyperion • \$19.95) <i>Motivate employees the Pike Place Fish Market way.</i>	7	8	3 ORDINARY PEOPLE, EXTRAORDINARY WEALTH by Ric Edelman (HarperBusiness • \$15) <i>Get tips from some regular folks who became rich.</i>	2	
4 FIRST, BREAK ALL THE RULES by Marcus Buckingham and Curt Coffman (Simon & Schuster • \$26) <i>A Gallup probe into managerial success.</i>	4	24	4 THE ONE MINUTE MANAGER by Kenneth Blanchard, PhD, and Spencer Johnson, M.D. (Berkley • \$12.95) <i>Management techniques in story form.</i>	5	5
5 THE ART OF INNOVATION by Tom Kelley, with Jonathan Littman (Currency • \$26) <i>Crafting breakthrough products the IDEO way.</i>	8	3	5 THE 9 STEPS TO FINANCIAL FREEDOM by Suze Orman (Three Rivers • \$13.95) <i>Learn to save.</i>	3	
6 NOW, DISCOVER YOUR STRENGTHS by Marcus Buckingham and Donald O. Clifton, PhD (Free Press • \$26) <i>How to bolster your true talents.</i>	6	4	6 THE 7 HABITS OF HIGHLY EFFECTIVE PEOPLE by Stephen R. Covey (Fireside • \$14) <i>Habitually popular.</i>	4	7
7 CREATIVE DESTRUCTION by Richard Foster and Sarah Kaplan (Currency • \$27.50) <i>Corporate change that's in sync with the capital markets.</i>	--	1	7 WHAT COLOR IS YOUR PARACHUTE? by Richard Nelson Bolles (Ten Speed Press • \$16.95) <i>The enduring job-search bible.</i>	6	
8 GUNG HO! by Ken Blanchard and Sheldon Bowles (Morrow • \$20) <i>How Walton Works No. 2 fired up its employees.</i>	--	25	8 RICH DAD'S CASHFLOW QUADRANT by Robert T. Kiyosaki, with Sharon L. Lechter, CPA (Warner • \$17.95) <i>Move from job security to independence.</i>	10	1
9 THE TIPPING POINT by Malcolm Gladwell (Little, Brown • \$24.95) <i>Discovering what turns an idea into a hot trend.</i>	10	14	9 THE MILLIONAIRE NEXT DOOR by Thomas J. Stanley, PhD, and William D. Danko, PhD (Pocket Books • \$7.99) <i>The wealthy among us.</i>	8	3
10 HIGH FIVE! by Ken Blanchard and Sheldon Bowles (Morrow • \$20) <i>Way to go, team!</i>	--	1	10 THE INNOVATOR'S DILEMMA by Clayton M. Christensen (HarperBusiness • \$16) <i>New technologies' disruptive effects.</i>	--	
11 LONGABERGER by Dave Longaberger (HarperBusiness • \$25) <i>How baskets became big business.</i>	5	2	11 RICH DAD'S GUIDE TO INVESTING by Robert T. Kiyosaki, with Sharon L. Lechter, CPA (Warner • \$19.95) <i>Becoming rich, not merely comfortable.</i>	11	1
12 RAVING FANS by Ken Blanchard and Sheldon Bowles (Morrow • \$20) <i>Turn customers into your biggest boosters.</i>	15	33	12 BUILT TO LAST by James C. Collins and Jerry I. Porras (HarperBusiness • \$16) <i>How 3M, Wal-Mart, and others became standouts.</i>	13	4
13 GETTING THINGS DONE by David Allen (Viking • \$24.95) <i>Start by getting an in-box.</i>	12	4	13 THE ERNST & YOUNG TAX GUIDE 2001 by the Tax Partners and Professionals of Ernst & Young LLP (Wiley • \$16.95) <i>Filing for an extension?</i>	9	
14 THE 21 IRREFUTABLE LAWS OF LEADERSHIP by John C. Maxwell (Thomas Nelson • \$22.99) <i>A minister's down-to-earth rules.</i>	--	7	14 THE 48 LAWS OF POWER by Robert Greene (Penguin • \$15) <i>Thoughts of power brokers distilled.</i>	15	
15 THE HR SCORECARD by Brian E. Becker, Mark A. Huselid, and Dave Ulrich (Harvard Business School Press • \$29.95) <i>Human capital as a strategic asset.</i>	--	1	15 THE LEXUS AND THE OLIVE TREE by Thomas L. Friedman (Anchor Books • \$15) <i>Globalization and its discontents.</i>	--	

BusinessWeek's Best-Seller List is based on a survey of chain and independent booksellers that carry a broad selection of books on economics, management, sales and marketing, small business, investing, personal finance, and careers. Well over 1,000 retail outlets nationwide are represented. Current rankings are based on a weighted analysis of unit sales in April.

Reviews and more are available on AOL (Keyword: BW) or www.businessweek.com

HOT TYPE FROM LEAST LIKELY TO SUCCEED TO THE Baron of Baskets: That's Dave Longaberger's life story in a nutshell. His posthumously published *Longaberger* combines autobiography with folksy, clichéd rules for success. The book is this month's No.11 hardcover.

A great believer in himself, Longaberger overcame difficulties, such as stuttering and epilepsy, to become an entrepreneur, starting with a restaurant and grocery store. He eventually, um, placed all his eggs in one basket: the Longaberger

Basket Company. This expanded version of his father's cottage industry would in time become a \$1 billion home-decor manufacturer, employing 8,700 people. Its sales take place at Topperware-party-like "basket shows," where now the book gets plugged. The ever-cheerful Longaberger makes business-building sound like a breeze, even when facing layoffs, showdown with the IRS, or bankruptcy. But be prepared: The relentless chirpiness may leave you feeling frayed.

BY KARIN PEKARC

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IT'S A DIFFERENT KIND OF WORLD.
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BY STEPHEN H. WILDSTROM

tech&you@businessweek.com

IT MAY BE TIME TO MOVE TO A NEW OFFICE



With Office XP, Microsoft has focused on making existing features more usable

Microsoft Office has been in a bit of a rut of late. The current version of the dominant productivity package, Office 2000, was designed largely to make life easier for corporate systems administrators. As a result, many home users, including me, have chugged along happily with the four-year-old Office 97. But the new Office XP, which went on sale May 31, returns the focus to individuals and gives us good reason to consider upgrading.

Don't look for dramatic changes in Word, the Excel spreadsheet, the Outlook contact and mail manager, or the PowerPoint presentation program, all of which are compatible with documents created in earlier versions. These core Office applications are mature products that will evolve slowly. The emphasis in Office XP (not to be confused with the Windows XP operating system, due in October) is on making existing features more usable. And here Microsoft Corp. has done well.

The most important changes to Office are called the Task Pane and Smart Tags. The Task Pane is a window on the right side of the program's working area, but it can be moved anywhere. It contains helpful information relevant to what you are doing at the moment, though exactly what it shows depends on which of several panes you have selected. My favorite is the Reveal Formatting pane, which gives all the information about currently selected text. Click on a link, such as "font" or "indentation," and you are presented with a dialog box that allows you to change the setting. No more remembering which of Word's myriad menu choices is the right one.

Smart Tags are an extremely versatile way to help people discover and use features of the programs. When your cursor passes over text that has a Smart Tag attached, a special icon appears. Click on it, and you get a menu of actions. For example, a Smart Tag attached to what Word thinks is a person's name offers a list of choices, including the option of entering an address or sending e-mail (both work only for names in your Outlook contact list). Click on an address and, if you are connected to the Internet, your Smart Tag choices include a map or driving directions to the location.

I suspect that Microsoft added some of these features just because it could. How often will I

really want directions to someone's office who typing her name in a letter? But other uses Smart Tags are a lot more practical.

The tags can help tame what is simultaneously one of the most powerful and annoying features of Office applications, especially Word's automatic formatting and correction of text. For example, Word assumes that a period should be followed by a capital letter unless the period comes after a known abbreviation. Some people like this, but it drives others crazy.

You've always been able to turn the feature off, but that option was well-hidden. Now, even automatic change generates a Smart Tag that lets you control the behavior. In the case of auto-capitalization, one choice undoes the capitalization in this instance. A second turns the feature off. A third tells Word never to capitalize after that abbreviation. And a fourth gives a list of auto-correction options to turn on or off. Companies will be able to extend the usefulness of Smart Tags by creating their own—for example, to provide instant help in filling out forms.

I hope Smart Tags represent a trend. In the past, Microsoft and other publishers have us



the growing power of computers to pile on features most people never discovered. Now, computational muscle is going into tools that make programs easier to use. (Contrary to Microsoft's own reports, the annoying Clippy has not met its demise. But the unhelpful talking paper clip now automatically off unless you turn it on.)

Office XP is being sold in a variety of packages. Standard includes Word, Excel, PowerPoint, and Outlook for \$479, or \$239 as an upgrade. Professional adds the Access database for about \$100.

At those prices, many people may stick with what they have, especially since older programs work just fine. But for the first time in four years, an upgrade for individual Office use may be worth the time and trouble.

BusinessWeek online

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BY LAURA D'ANDREA TYSON

IGNORING CALIFORNIA'S ENERGY CRISIS IMPERILS THE ECONOMY



BLINDERS:
By refusing to consider temporary price caps, the White House puts California at the mercy of suppliers who can manipulate capacity

Rolling blackouts in California over the next several months endanger an already faltering U.S. economy. California accounts for about 14% of the nation's output, more than the smallest 22 states combined. In the past two years, it has generated about one-quarter of the nation's job growth. Like it or not, California's electricity crisis has national ramifications. Yet, after weeks of secret meetings, the Bush Administration's recently unveiled energy plan does nothing to ameliorate this crisis. Instead, the White House has used the crisis to justify a long-term "drill-and-burn" strategy that benefits its friends in the energy industry and poses unnecessary risks to the environment.

According to the Bush team's logic, soaring electricity prices in California, like soaring U.S. gasoline prices, reflect years of inadequate investment in energy production. And why have investors been unwilling to develop the necessary supplies? Primarily, say Administration officials, because of government regulation, especially environmental rules. This analysis is consistent with traditional Republican ideology but inconsistent with the facts. Private companies shelved investment plans and closed operations in the oil, gas, and electricity industries in the 1990s not because of environmental restrictions but because of sagging energy prices, excess capacity, and poor profitability.

When natural gas prices were low, Alaska's North Slope producers had no incentive to build a multibillion-dollar pipeline to supply the rest of the country. Last year, when prices jumped, the same companies announced plans to do so. Today, without any relaxation of environmental regulations, they are spending \$75 million on feasibility and design studies. Nationwide, the number of rigs drilling for natural gas is up 57% in the past year. Similarly, when the price of electricity was low, suppliers in California and elsewhere had little incentive to build new transmission and generating facilities.

Now, in response to higher prices, private power companies are finishing work on plants that will add 92,000 megawatts to the nation's capacity by next year. This is a larger increase in capacity than any in the previous decade and nearly a quarter of what the Energy Dept. deems necessary to meet demand growth through 2020. This investment surge has not required weaker federal regulatory standards.

Flaws in California's deregulation plan have aggravated its electricity woes. By the time the wholesale price for electricity rose to levels en-

couraging the development of new capacity, it was too late for the state to avoid a short-term crisis. To make matters worse, because the deregulation plan precluded long-term contracts between utilities and generators, there was no way for either buyers or sellers to hedge against the volatility of prices in unregulated electricity markets.

Such contracts have been a feature of successful deregulation plans elsewhere, preventing large fluctuations in electric bills while encouraging suppliers to maintain excess capacity.

SAVVY SELLERS. The Bush Administration is responsible for California's self-inflicted wound, but it is responsible for failing to impose a temporary cap on wholesale electricity prices in order to control their manipulation by a handful of generators and natural gas suppliers, many headquartered in Texas. Economists have long recognized that tight conditions in electricity markets put sellers in a very strong position to exert market power by withholding supply to drive prices upward. There is compelling evidence that savvy sellers are doing just that in California. Indeed, there is no other explanation for the tenfold increase in wholesale prices in less than one year.

The White House sneers at such evidence, arguing that a price cap would discourage needed investment in new capacity. But not if such caps were set at a level high enough to provide suppliers with a reasonable profit and relief once the short-term crisis was over. The price cap bill proposed by Senators Dianne Feinstein (D-Calif.) and Gordon H. Smith (R-Ore.) satiates these conditions but has been steadfastly opposed by the Bush team and its supplier friends.

Although a temporary price cap would satisfy conditions in California and the Western grid, existing capacity constraints exacerbate drought-induced shortages in the state's hydroelectric dams make substantial shortages inevitable over the next several months. According to Vice-President Dick Cheney, conservation can be a sign of personal virtue, but it is not a sufficient basis for a sound energy policy. But over the next several months, conservation is the only way to handle electricity shortages in California. The question is whether conservation will be voluntarily encouraged by real rate increases for residential users and more aggressive cutbacks in air conditioning, or involuntary—caused by blackouts that threaten the nation's economic well-being. Either way, California gets no help from the Bush Administration's energy strategy.

Laura D'Andrea Tyson is dean of the Haas School of Business at the University of California at Berkeley.



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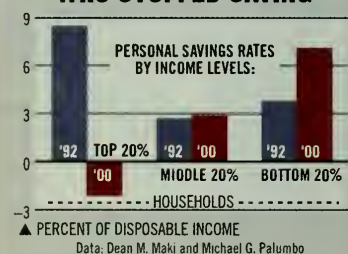
BY GENE KORETZ

UNRAVELING THE SAVINGS MYSTERY

Big spenders of the '90s exposed

Despite the latest Wall Street rally, the value of U.S. equities remains nearly 20% below its peak 14 months ago, and many observers still expect households spooked by falling stock market wealth to rein in consumption sharply. In light of the negative personal savings rate, they claim that those

SURPRISE: IT'S THE AFFLUENT WHO STOPPED SAVING



who stopped saving and began spending wildly during the market boom will now tighten their purse strings and put a lot more aside to rebuild savings.

At least as far as this picture applies to the behavior of average Americans, however, a new Federal Reserve staff working paper indicates that it is seriously flawed. Despite widening public ownership of stocks, it finds that most people did not boost their spending as a result of the market boom. Almost the entire drop in the personal savings rate, it concludes, reflected the actions of the most affluent households—the top 20% in the income scale.

In the study, economists Dean M. Maki and Michael G. Palumbo draw on data from both the Fed's triennial survey of consumer finances and its Flow of Funds report. The first provides details on household balance sheets by income level in 1992, 1995, and 1998; the second records aggregate shifts in the household sector's various assets and liabilities over the past decade. Acting on a suggestion by Fed Chairman Alan Greenspan, the authors combined the two data sources in order to estimate changes in saving behavior by different income groups.

Between 1992 and 2000, they report, the household sector on a net basis sold \$2.3 trillion of directly held stock, near-

ly 50% more than its net purchases of equity and bond mutual funds. And the biggest share of directly held equities—some 80% in 2000—were owned by the top 20% of households.

Thus, the data suggest that these affluent households drastically reduced their saving by selling stocks and spending the proceeds, even as the soaring value of their remaining equity holdings greatly increased their wealth. The result, the authors estimate, was a sharp drop in their savings rate from 8.5% of disposable income in 1992 to a negative 2.1% in 2000.

But this wasn't true for the vast majority of households. Indeed, far from cutting savings, most began squirreling more of their incomes away, with the savings rates of the bottom 40% of households rising from around 4% in 1992 to over 7% in 2000.

Maki and Palumbo conclude that "all of the consumption boom of the latter 1990s and virtually all of the decline in the personal savings rate in the last decade can be attributed to the richest groups of households." They also estimate that the top 20% of households accounted for 46% of total consumer expenditures last year.

Whatever the size of the wealth effect on overall consumption over the next year, the study's implications for the pattern of spending cutbacks seem clear. Unless the stock market moves to even higher ground and stays there, luxury goods, expensive cars, trophy homes, and other high-end items are likely to suffer from sagging sales.

THE YOUNG AND THE DISABLED

Disturbing signs of declining health

There's no question that senior citizens these days are enjoying healthier, more active lives. But a new study by Rand Corp. economists Darius Lakdawalla, Dana Goldman, and Jay Bhattacharya suggests that this trend toward improving health could conceivably halt or be reversed in future decades.

The authors confirm earlier research findings that disability among those over 65 has fallen since the early 1980s—presumably because of medical advances and a decline in smoking and other bad health habits. Their analysis of recent disability trends among younger Americans, however, is less reassuring.

Specifically, after declining in the 1970s, the disability rates of those in

their 20s to their 50s actually tend to rise between the mid-1980s and the mid-1990s. Among those in their 40s, the rate of disability rose at least half percentage point, or 20% to 30%.

While some of this increase in reported disability may reflect the greater availability of government disability insurance benefits, the researchers argue that it mainly stems from deteriorating health. They note, for example, that has coincided with significant rises in the incidence of obesity, diabetes, and asthma—illnesses that can cause disability among those most severely afflicted.

Such a trend is ominous, to say the least. If a rise in disability among the young translates into a rise in disability among the future elderly, Medicare and the health system will face even greater pressures than currently projected.

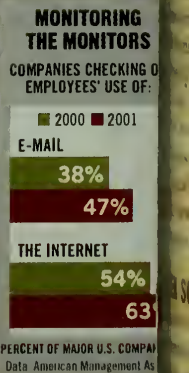
BIG BRO IS EYEING YOUR E-MAIL

How employers scrutinize PC use

Skeptics of the productivity-enhancing effects of office PCs often point out that workers are spending more and more of their time online on pursuits as personal e-mail, shopping, and visiting entertainment sites. A new American Management Assn. survey indicates, it's a charge that employers aren't taking lightly.

According to the AMA, nearly 80% of major U.S. companies now keep tabs on their employees by checking their e-mail, Internet, or phone connections, or even videotaping them. Four years ago, only 35% of companies engaged in such active monitoring.

The most intensely checked activities are employee e-mail and use of the Internet. Some 47% of big companies now review employee e-mail, the AMA reports, up from 15% in 1997 and 38% last year. And the share of employers monitoring workers' Internet connections has jumped from 54% to 63% in the past year alone. Indeed, 25% of those surveyed report that they have fired employees for misuse of the Internet or office e-mail.



JAMES C. COOPER & KATHLEEN MADIGAN

IT'S TIME TO NAIL DOWN WHAT THE R-WORD REALLY MEANS

recession is more complex than just a drop in GDP

U.S. ECONOMY

When your neighbor is out of work, that's a recession; if you're out of work, it's a depression. As definitions of recession go, that old saying captures the right tone of the pair. A more sophisticated rule of thumb says a recession is two consecutive quarters of declining real gross domestic product. Actually, neither definition is very accurate.

The popular press, executives, and politicians are quick to bandy about the R-word, probably because recession is a more dramatic—and more easily hyped—condition than sluggish growth. But to follow what the economy is truly doing, and to get a clear idea of how

policy makers at the Fed are thinking, it is important to understand how economists define recession.

For that, go to the source: the Business Cycle Dating Committee of the National Bureau of Economic Research (www.nber.org). It's a group of academic economists who for decades have determined the months in which recessions have begun and ended. According to the NBER, "A recession is a significant decline in activity spread across the economy, lasting more than a few months, visible in industrial production, employment, real income, and trade" (table).

A recession is more than a slowdown that lifts the interest rate, or a drop in demand that affects a single sector, such as manufacturing. The entire economy actually shrinks. The growth process goes into reverse as economic weakness spreads from one sector to another until it begins to feed on itself. It's like a coiled spring that suddenly snaps and begins to unwind.

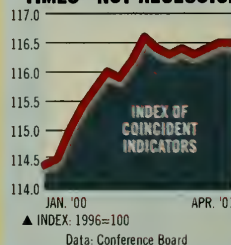
So far, growth has only turned weak, but the economy is not unraveling in the classic recession way. And stimulus from the Fed's lower rates and the expected tax cuts will soon provide a lift. Those two policy actions are why growth in the second half should be no different than in the first.

IN SO, amid all the uncertainty—and hype—about the state of the economy, the NBER decided to issue a communiqué on May 15 that explains why its committee has not yet met to discuss the onset of a recession.

Basically, the Bureau says that data through April are inconclusive. Of course, keep in mind that the NBER moves slowly. It did not set the July, 1990, start of the last recession until April, 1991, a month after the downturn was later determined to have ended.

Right now, the economy's path looks more flat than down (chart), based on the Conference Board's index of coincident indicators. This index is important because it is made up of the same four data series that the NBER examines when its economists sit down to date the start of recessions and expansions. The index was unchanged in April, after rising 0.1% in both February and March, and it has been going sideways since last September. By comparison, the index fell sharply from July through November of 1990. Even the unrevised data made it evident that the recession had begun by the end of 1990.

SO FAR, A SIGN OF SLOW TIMES—NOT RECESSION



Data: Conference Board

WHAT THE NBER IS WATCHING

	PEAK-TO- TROUGH 1990-1991	PEAK-TO- APRIL 2000-2001
INDUSTRIAL PRODUCTION	-4.5%	-2.8%
ROLL EMPLOYMENT	-1.6	-0.2
REAL BUSINESS INCOME	-5.1	-0.9
REAL HOUSEHOLD INCOME*	-2.6	+0.8

* Transfer payments, Sept. 2000 to Sept. 2001
Data: Federal Reserve, Labor Dept., Conference Board

OF THE FOUR COMPONENTS of the coincident index, the two that weigh most heavily in the NBER's determinations are industrial production from the Federal Reserve and payroll employment from the Labor Dept. But despite the recent weakness in each of these indicators, the declines do not yet add up to a recession.

For example, the NBER notes that industrial production peaked in September, 2000, and has since declined 2.8%. In the 1990-91 recession, the peak-to-trough drop was 4.5%. To match that, output would have to drop substantially in the next several months, making industrial activity a key indicator to watch.

However, the Bureau points out that industrial production is a small and declining part of the economy. That's why the broader payroll employment data will also be a crucial benchmark in coming months. But here again, payroll employment, while having fallen 276,000 since February, is far from matching its declines in the 1990-91 recession, which totaled 1.8 million.

Sharply weaker demand is also a key element of recessions, since it is the interaction between demand, output, and employment that creates a downturn's vicious cycle. For this, the NBER looks at personal income and business sales, adjusted for inflation.

On that score, sales by manufacturers, wholesalers,

and retailers are now down 0.9% from their August, 2000 high, while their peak-to-trough drop in the last recession was 5.1%. Personal income, which fell 2.6% in the last downturn, has been growing since last autumn. This pattern emphasizes the importance of consumers in the outlook, and it shows why their unflagging demand has kept the index of coincident indicators from falling, despite the declines in output and jobs.

Demand is also where the Fed's efforts to stimulate growth will come into play in the coming months. The Fed's unprecedented aggressiveness is the chief reason for optimism that the current economic weakness will not devolve into a recession—and a likely key reason why the NBER has not yet scheduled a meeting about the business cycle. Clearly, the Bureau wants to see how this policy plays out. The Fed's May 15 rate cut brings the Fed's benchmark federal funds rate to 4% from 6.5% at the beginning of the year, and another cut still seems likely when the Fed next meets on June 26-27.

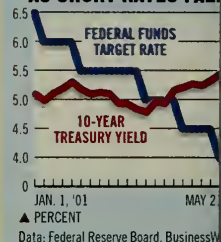
THE FED HAS TAKEN POLICY from restrictive to accommodative in less than five months, providing stimulus that will begin to hit the economy this fall, not to mention the coming impact from tax cuts. The real federal funds rate, which is the rate adjusted for expected inflation, has fallen well below its average level of the past 15 years.

Plus, the yield curve, illustrated by the difference between short- and long-term interest rates, has gone from inverted to positively sloped. That is, long rates are now greater than short rates. Indeed, in the past few months the fed funds rate dropped by 100 basis points but the yield on 10-year Treasury bonds rose 60 basis points. That means the credit markets are betting the Fed stimulus will lift the economy (chart).

Bondholders are demanding a bigger payoff for their investments because strongly stimulative policies could lift inflation next year, forcing the Fed to take back some of this year's rate cuts. But for now, the Fed seems unmoved by the bond market's behavior. In its May 15 policy announcement, it went out of its way to downplay price pressures, saying inflation "is expected to remain contained."

But inflation is a question for 2002. Right now, the topic is recession. Some of the key data are pointing the wrong direction, and second-quarter real GDP may even decline. So far, however, it's a good bet that the Fed's rate cuts will keep the economy's weakness from becoming so significantly deep, widespread, or lasting as to cause the NBER to declare a recession.

LONG RATES TURN UP AS SHORT RATES FALL



BRAZIL

DOUBLE BLOWS STAGGER THE INDUSTRIAL SECTOR

An energy crisis may chill Brazil's economic growth at the same time that a weaker currency is making rising inflation more of a problem.

South America's largest nation is grappling with the prospect of energy rationing and rolling blackouts. Brazil's electric grid depends on hydropower, but a long drought in the south-east region has caused a drop in energy production. In addition, Brazil has not added enough power-generating plants to keep up with the rise in energy demand.

On May 18, the government announced a rationing plan to start on June 1. Industry is expected to cut power use by at least 15%,

but such a drop will curtail factory activity at a time when the economy is already slowing. Real gross domestic product in the first quarter grew 3.77% from a year ago, down from a 4.46% gain in the fourth quarter.

The industrial sector has fueled almost all of the rise in real GDP. The output of capital goods has been particularly strong (chart).

Now, industry will be hampered by energy problems as well as by higher interest rates. The central

bank has tightened significantly this year in a bid to stop the rise in inflation. A key measure shows that consumer prices were up 0.58% in April, on top of a 0.38% advance in March. In just the first

four months of this year, prices are up 2% with the central bank's inflation target for all of 2001 between 2% and 6%.

Inflation is also up because a weak real is lifting import prices. The Brazilian currency has been sinking this year because of neighboring Argentina's financial woes and a scandal in Brazil's Congress. The real fell further when Argentina had to accept a higher interest rate when it sold some Treasury bills in late May. In addition, the scandal may well continue for weeks and delay action on Brazil's pressing economic and energy problems.

For now, Brazil's real GDP is expected to grow by about 3% in 2001. But the energy crisis, as well as higher interest rates, threaten to slow growth even further.

CAPITAL GOODS SPUR OUTPUT GAINS



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WILL WE FEEL THE TAX CUT?

A slow phase-in means any economic benefits may be thin

The GOP Senate may be slip-sliding away. But despite the sudden change in George W. Bush's political fortunes, you can't take this away from the President: He stands on the brink of a political triumph in his battle for a sweeping tax cut. Whether it is also an economic triumph remains to be seen. That's because the proposal that will soon pass Congress represents a complex set of compromises that, in many ways, dilutes the economic punch of his marginal-rate reductions.

Outwardly, the measure closely resembles the plan on which Bush campaigned. But lawmakers struggled to fit his package into a \$1.35 trillion budget envelope. And in the Senate, they aligned more of the cuts toward lower- and middle-income Americans. As a result, many upper-bracket tax breaks are being stretched out for so many years that it would take a GOP dynasty to cement them into law.

How come? The bill that passed the Senate on May 23 was laced with a series of phase-ins and phase-outs. Consequently, that plan—which will likely resemble the version that will be adopted soon by House and Senate negotiators—cuts some taxes immediately while delaying other provisions for as long as a decade.

A new 10% bracket for low-income families, for example, would be retroac-

tive to Jan. 1, 2001. So would a small increase in the child credit. But hefty earners shouldn't look for big cuts soon: The top 39.6% tax bracket isn't set to drop to 36% until 2007. Provisions that would ease the marriage penalty would not begin to kick in until 2006 and would not be fully effective until 2011. And it will be nearly a decade before the estate tax is repealed.

As a result, the Senate bill includes tax cuts totalling only \$270 billion by fiscal 2004. The bulk of the cuts, more than \$800 billion, take effect between 2007 and 2011. "There are some very big things on the table," says Robert Bixby, executive director of the Concord Coalition, a budget-reform group. "But people don't have a sense of the time it will take for many of them to be accomplished."

Because so much relief for top-bracket taxpayers is de-



played for so long, many of the benefits in the first few years go to low- and middle-income taxpayers. Folks earning under \$40,000 would get one-third of all the cuts this year, says the Congressional Joint Committee on Taxation, while those making more than \$100,000 would get only 2%.

The leisurely phase-in will also dilute some of the short-term economic impact. Only \$20 billion of the Senate bill would actually get into taxpayer's pockets this year, barely a blip in a \$10 trillion economy. Because the tax reduction takes over a decade to implement, its value in today's dollars is far less than if it occurred right away.

None of this diminishes Bush's political achievement. The final tax

bill won't be the \$1.6 trillion bonanza he fought for, but it is close enough for a momentum-building victory. "There's an old saying that goes, 'It doesn't matter if you win or lose in Washington, so long as you win,'" says Republican pollster Bill McInturff. "The fact is, this cut is much bigger and is coming much sooner than anyone expected."

Moreover, it represents a big step toward another conservative goal: By draining more than a trillion dollars from federal coffers, it makes it tougher for Congress to continue to spend rapidly. Says Senator Joseph Biden (D-Del.): "This fight was about fundamentally changing the role of government, and Republicans are beating the devil out of us. Not only is the money gone, but once the rate cuts are locked in, they are very hard to eliminate politically."

Still, the long delays before tax cuts kick in may create both political and economic problems for Bush and the GOP, too. For starters, Hill Republicans who must run for reelection in just 18 months are not happy with slow tax relief. "I'm concerned," says Senator John Warner (R-Va.). "My constituents are going to say, 'Hey, wait a minute. I heard about this tax cut you passed. Show me the check.' There's no beef in this bun."

IFFY THEORY. A bigger disappointment may loom on the economic front. Backers of rate cuts didn't just argue that they would help short-term consumption, thus jump-starting today's slow economy. They also make the supply-side claim that tax cuts for wealthier individuals would increase savings and investment, which, in turn, would enlarge the pool of capital for business. Companies would use that cash to buy equipment, which would spike worker productivity and strengthen the economy. The result: another Reagan-type boom. Rate reductions, says Daniel Mitchell of the Heritage Foundation, "will boost economic performance by increasing incentives to work, save, and invest."

But economists continue to debate whether that theory lives up to its promise. While the economy

THE IMPACT OF TAX RELIEF

WHITE HOUSE CLOUT

If the coalition that passed the tax bill hangs together, it may mean future wins for Bush in health care, education, and business tax cuts.

SHORT-TERM ECONOMICS

By providing a modest boost to consumer spending this year, it could raise GDP growth by about 0.5%. Still, most tax-payers won't benefit much until 2002.

LONG-TERM ECONOMICS

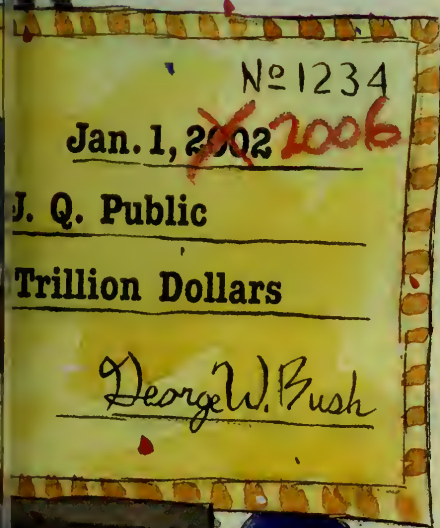
Trimming marginal tax rates should eventually provide some stimulus. But the slow phase-ins of top-bracket cuts will dull that impact, while the lack of business tax relief will limit any boost in capital spending.

SOCIAL SECURITY

Funding the tax cut means Bush may have trouble coming up with money to bankroll a shift to Social Security private accounts.

GOVERNMENT SPENDING

Pressure on Congress to hold down domestic spending will grow. But Bush may have to delay Pentagon projects like the Star Wars missile-defense system.



soared after the massive Reagan tax cuts of 1981, plenty of the investment incentives in his bill were repealed before they ever took effect. And many economists are convinced that the growth of the '80s was really spurred by the Federal Reserve's efforts to crush inflation.

To add to the muddle, the economy boomed again after Bill Clinton raised taxes in 1993. "In the '80s, we cut taxes, and the economy grew. In the '90s, we saved the surplus, and the economy grew," says Brookings Institution economist William G. Gale.

In truth, tax rates may matter less to the economy's long-term performance than monetary policy, technological innovation, and global competi-

tion. That's especially true with individual rate changes, because it's hard to figure out how much will be spent and how much will be saved. "The evidence that anybody changes their behavior very much is sparse," insists Joel B. Slemrod, director of the Office of Tax Policy Research at the University of Michigan.

MUTED EFFECT. The current tax bill is especially tricky to gauge. For starters, the top-bracket cuts are small compared with Reagan's, which took the top tier down to 50% from 70%. And while Reagan's individual cuts kicked in over just three years, in this year's Senate bill it takes seven. "It just mutes the effects because it takes so long," says Alan J.

Auerbach, a tax economist at the University of California at Berkeley.

More troubling to supply-siders: Most top-bracket trims could eventually be aborted by a future President and Congress. "When they are desperate to turn the economy around, they cut taxes," says Stephen J. Entin, a veteran of the Reagan Treasury Dept. "As soon as they get going, they take the money away."

History suggests that his fears are well founded. Despite his popularity, Reagan's 1981 tax cut was followed by hikes in '82, '83, and '84. It was a similar story in 1986. In the massive tax-reform act that passed that year, Congress slashed the top rate over three years so that it hit 28% by 1988. But by 1991,

JEFFORDS

A defection could undermine Bush's small-government agenda



SENATE MATH: THE POWER OF ONE

At a recent Washington affair, George W. Bush joked that the lesson of his Florida electoral ordeal was simple: "Don't peak too soon."

Little did he know. As *BusinessWeek* went to press on May 24, the President was in danger of being dealt a stunning setback by, of all people, a soft-spoken Vermonter named James M. Jeffords. A GOP moderate who faced ostracism from conservatives over his role in paring down Bush's tax cut, Jeffords reacted badly to a string of threats and snubs. On May 23, he was poised to abandon the Republican Party and formally announce plans to become an Indepen-

dent. The result: A Democratic majority in a Senate that has been vital to Bush.

Moreover, Jeffords' expected leap into the unknown could just be the beginning of a period of Borgia-like intrigue that could roil the normally staid upper chamber. Emboldened by Jeffords' move, Democrats are stepping up attempts to get another lonely GOP moderate, Rhode Island's Lincoln D. Chafee, to follow suit. So far, he's staying put. And Republicans have promised Zell Miller, Georgia's right-of-center Democrat, the moon and several outer planets in hopes of luring him.

Miller's answer so far: No dice. The tur-

moil could grow if two other Senate stalwarts, Strom Thurmond (R-S.C.) and Robert G. Torricelli (D-N.J.) part. Thurmond is in fragile health. Torricelli faces pressure from his fund-raising.

SEISMIC SHIFT. If Jeffords does it means bye-bye to Majority Whip Trent Lott (R-Miss.) with his bluster and iron rule, and hello, to Daschle (D-S.D.). Farewell, to committee chiefs who wanted Bush's agenda to passage before 2002 elections. Before Jeffords' seismic shift, the President was riding on the equivalent of Intern-

en-President Bush moved his lips and
umped it back up to 31%. In 1993, Pres-
ent Clinton hiked it to 39.6%.

Before Dubya's bill is fully effective,
ere will be two Presidential elections
id five congressional elections. Tax pol-
y "will be changed many times over
e next 10 years," says ex-Congres-
sional Budget Office Director Rudolph
Penner.

Nonetheless, some economists think
e symbolism of the Bush tax cut is at
ast as important as the dollars it adds
people's pockets. The promise of the
ll, perhaps more than its reality, could
ek up consumers spending. It could also
rk up Wall Street by signaling to in-
vestors that lawmakers are willing to
nit Washington's tax take, says Pierre
dis, senior economist at Primark Deci-
on Economics Inc. "It's a change in phi-

losophy." Investors "can see that the
[after-tax] return on investment down
the road is going to be higher."

Is there any way Bush can lock in
these changes or even add to them?
It will be a struggle. He is trying to
placate both supply-siders and busi-
ness by holding out the prospect of a
second tax cut later this year. That could
give the corporate crowd, left out in
Bush's first swing at the tax code, a
chance to push for liberalized depreciation
and other breaks. Says the GOP's McIn-
turff: "This bill is the camel's nose under
the tent. If the economy stabilizes, we
can come back for more cuts."

Trouble is, by draining much of the
anticipated surplus over the next decade,
today's tax cuts will not only squeeze
spending but they will also make it
tougher to find the money for more. And

the expected decision by Ver-
mont Senator James Jeffords to
abandon the GOP will give Dem-
ocrats control of the Senate,
lengthening the odds against Bush win-
ning another big tax reduction.

If an economic rebound lifts all
boats, Bush's tax-slashing will look
golden. Continued surpluses would pro-
vide the money to lock in today's tax
cuts and enact future reductions. Even
if the boom is not revived, tight bud-
gets will help the GOP fend off Dem-
ocrats' spending plans. That's precisely
the kind of "heads Bush wins, tails our
party loses" scenario that worries Dem-
ocrats today even as they cheer their
brighter Senate prospects.

By Howard Gleckman, with Lee
Walczak and Lorraine Woellert, in
Washington

trying to rush conservative ap-
s and programs through the
in a compressed two-year burst.
shuffled Senate isn't expected to
he \$1.35 trillion tax cut. Jeffords
leagues he will vote for the Sen-
ation of the measure before
g affiliation. But the shift could
ine the rest of Bush's small-gov-
t agenda. "Bush can declare a
victory," says
artner Harry
nan. "But it's
o be a lot
for him to get
g done after

repercussion
be the sweep-
nges in committee leadership.
er the new Bush energy plan.
-gas drillers were counting on
Energy Committee Chairman
H. Murkowski of Alaska to add
e production incentives to the
e. Now, both the breaks and
pro-development tilt are at risk.
esumed new Democratic chair-
ew Mexico's Jeff Bingaman, is a
moderate who lacks Murkow-
ong industry ties. "Now there
more emphasis on renewables,
ation, and environmental protec-
ays Kim Wallace, chief political
at Lehman Brothers Inc.
Vermont Mutiny could also crip-
ite House plans to nominate con-
res to the federal bench. Under
y Committee Chairman Orrin G.
R-Utah), Bush expected to get
his picks through. If control
o liberal Democrat Patrick
of Vermont, many nominees are
o be rejected. And chances
lim for naming a strict construc-

DASCHLE

Would he be
able to disci-
pline his newly
empowered
Senate troops?



ship, he's expected
to take control of
the Environment
panel.

Defense Secre-
tary Donald H.
Rumsfeld's plans
for billions in new
Pentagon spending
(page 51) would
likely be under at-
tack with a new
Senate regime. At
Armed Services, Michigan liberal Carl
Levin would be in. Out: Defense cheer-
leader John W. Warner (R-Va.). Rums-
feld could face withering fire from
Levin and Democratic Appropriations
baron Robert C. Byrd of West Virginia.

Bush's push for new trade agree-
ments would also run into trouble if
Senate Commerce, now run by free-

trader John McCain (R-Ariz.), goes over
to South Carolina retro-Democrat
Ernest F. Hollings, a protectionist. Still,
that may have a silver lining for Bush:
McCain, a thorn in the President's hide,
would lose his soapbox.



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to South Carolina retro-Democrat
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that may have a silver lining for Bush:
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would lose his soapbox.

Another consolation is that the Sen-
ate Finance Committee, which helped
give Bush his big tax victory, wouldn't
change ideological coloration much.
Democratic moderate Max S. Baucus
of Montana would likely head the com-
mittee. He's already on the outs with
liberals for allying with GOP Finance
honcho Charles E. Grassley (R-Iowa) to
draft the bipartisan pact that gave
Bush many of his tax cuts.

ENEMY HANDS. What would it all
mean? Life may be about to get much
more difficult for Bush. Up to now, he
relied on bipartisan Senate coalitions
to give his plans propulsion. In a 50-49
Senate with Democrats in charge, he

LOTT

Without his
clout, Bush
would have to
rely on House
conservatives

will be under
greater pressure to
cut deals with mod-
erate Democrats.

To further compli-
cate matters, a Sen-
ate in enemy hands
forces Bush to rely
more on the GOP-led
House. But that's where arch conserva-
tives such as Majority Whip Tom De-
Lay (R-Tex.) and Majority Leader
Richard K. Armey (R-Tex.) reign. The
two favor ideological shoot-outs over
legislative compromise. With partisan-
ship on the rise and his Senate cushion
potentially gone, Dubya would face
tough going for the rest of his agen-
da—and the prospect of three long
years in a Balkanized capital.

By Lee Walczak with Lorraine
Woellert and Washington bureau reports

COMMENTARY

By Rich Miller

IF THE WORST IS OVER, WHY IS THE FED SO TENSE?

What downturn? Check out the financial markets in the last month, and everything seems finally to be coming up roses: The economy has weathered the worst and is ready to rebound. Despite some profit-taking on May 23, that's what investors seem to be betting. Stock prices have soared on hopes of fatter corporate profits later this year. After being battered to near bargain basement levels, the Nasdaq composite index has climbed more than 15% in the last five weeks (page 94). Bond yields have risen on expectations that improved consumer confidence will boost economic growth and lead to higher interest rates. The yield on the 10-year Treasury is up to 5.39%, vs. 5.20% a month ago. Even commodity prices are higher in anticipation of stronger demand from a revived economy. Gold is up more than \$20 an ounce since April 17.

Wall Street's exuberance, though, isn't shared by the Federal Reserve. Fed Chairman Alan Greenspan & Co. are a long way from breaking out the champagne glasses to toast themselves for another job well done. They're too busy grappling with a series of New Economy problems that could yet tip the U.S. into recession or leave it saddled with meager growth for months to come. **NEWFANGLED FEARS.** At the top of the Fed's worries: pinched corporate profit margins. In the Old Economy, these were less of a problem. Companies often were able to raise prices to recoup higher costs. But in the New Economy of cutthroat competition, that's just not possible. Faced with a squeeze on earnings, companies continue to slash capital spending and

pare payrolls, threatening to turn the slowdown into an outright slump.

Unfortunately, there's no end in sight to the erosion in corporate profits. According to data compiled by Thomson Financial equity strategist Joseph S. Kalinowski, Wall Street analysts continue to cut their earnings forecasts for the companies they follow. The numbers, which get passed on to the Fed and Greenspan, show that analysts on average expect operating earnings of companies in the Standard &

pected to slash capital outlays by 18% this year, according to Fed estimates. Semiconductor companies, which at the end of last year projected a 15% rise in their investment spending in 2001, now plan for a 25% cut.

The last New Economy issue confronting the Fed is the negative wealth effect. In the go-go years of the late 1990s, the ever-rising stock market fueled growth by boosting the paper profits of a growing legion of individual investors. The slump in the stock market since then is threatening to do the opposite and pull the economy down. Despite its recent rally, the Wilshire 5000 Total Market index is down nearly 20% from its high in March, 2000. In fact, Fed officials have been pleasantly surprised that the combination of the market slide and rising unemployment have not taken a bigger bite out of consumer spending. Fed insiders say



THE BULLS ARE RUNNING AGAIN

>>> Profits could soar later this year as tax cuts and lower interest rates boost growth.

>>> Share prices, particularly of high-tech companies, have fallen so far they're now a bargain.

>>> Consumer confidence has edged up again, raising hopes the economy can avoid a recession.

WHY



THE FED REMAINS WORRIED

>>> Pinched margins continue to force many CEOs to cut capital outlays and lay off workers.

>>> High-tech companies that spent heavily in the late 1990s are still saddled with excess capacity.

>>> Unemployment is rising, and the market slump left many investors poorer. Both could dampen consumer spending.

Poor's 500-stock index to fall 12% in the second quarter after dropping by 6.5% in the first. One glimmer of hope: The pace of the decline in the consensus forecast has slowed of late. Despite some recent jitters, investors have been looking past the ugly earnings reports due out this quarter to a hoped-for upturn later this year.

Capital-spending cutbacks are the second New Economy problem facing Greenspan and his fellow Fed policymakers. An investment boom in the late 1990s led to a surfeit of capacity and now threatens to give way to a capital-spending bust. The problem has been most acute among high-tech companies, which boosted capacity an astounding 48% last year. To try to bring things back into line, they're ex-

pected to slash capital outlays by 18% this year, according to Fed estimates. Semiconductor companies, which at the end of last year projected a 15% rise in their investment spending in 2001, now plan for a 25% cut.

Just like the high-tech CEOs who got caught in the downdraft, top Fed policymakers have no crystal ball to show them where the economy is heading. They're just hoping that five rapid-fire interest-rate cuts this year will set the stage for an economic revival. But faced with a New Economy slowdown, they're not so sure it will—no matter what the financial markets might be saying.

Miller covers the Federal Reserve from Washington.

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CRISIS MANAGEMENT

FORD'S GAMBLE: WILL IT BACKFIRE?

Blaming Firestone invites new scrutiny Ford can ill afford



The stakes don't get any higher than this. When Ford CEO Jacques A. Nasser dropped his bombshell that Ford Motor Corp. will recall some 13 million Firestone tires on May 22, he may have succeeded in deflecting attention from his beleaguered Ford Explorers for a time. But in the process Nasser made a dangerous enemy out of Bridgestone/Firestone Inc. chief and former business partner John T. Lampe, who seems intent to prove the Explorer unsafe.

What a mess. And what an end to a nearly century-old relationship. For months, it appeared that Firestone and Ford were working together to sort out the cause of the high number of tire failures and subsequent accidents that had roiled

scenes, Nasser's effort to push through sweeping cultural changes left morale low. Says Lehman Brothers Inc. analyst Nicholas Lobaccaro: "Every event like an Explorer recall, or another Firestone recall, is only going to make the stance more wobbly."

Why did Ford act now? After being harshly criticized last year for not detecting a pattern of deadly rollover accidents involving Firestone failures on Ford Explorers, Nasser vowed to begin an "early warning system" to ensure such tragedies never recur. In the past, Ford didn't have tire warranties, so it had no access to claims data. But beginning this year, tires were included under its vehicle warranties, so it began to build its own database.



"We simply do not have enough confidence in the performance of these tires keeping our customers safe"

— JACQUES NASSER, Ford Motor

both their companies last summer. But with Ford's decision to replace all Firestone tires at a cost of \$3 billion, Nasser has instead taken a huge financial and public relations risk.

The controversy hits at a time when Ford can ill afford missteps. Though it had largely been outperforming its Detroit rivals, its outlook has grown dimmer in recent months. The rollout of the redesigned Explorer has been hurt by recalls, and sales are below expectations. Ford's market share is shrinking, and inventories are bloated. Behind the

Clearly, it didn't like what it saw. Using statistical analysis of data culled from Firestone, government accident records, and its own laboratory tests, Ford concluded that some Firestone Wilderness tires that were not recalled last year "will probably experience elevated failure rates at some time in the future." While the potential failure rates are much lower than those that led to last year's recall, they are higher than the average tire, Ford says. "We simply do not have enough confidence in the performance of these tires keeping our

stomers safe," said Nasser in a May 22 press conference.

Ford's attack left Firestone scrambling to go on the offensive. Upon learning of Ford's huge recalls, Lampe told Nasser to make it would no longer serve as its supplier.

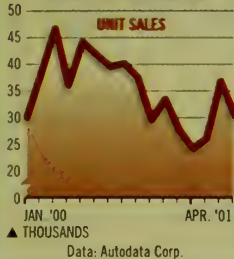
The move freed the automaker to attack the Explorer far more directly—and Lampe wasted no time.

"Our analysis suggests that there are significant safety issues with a substantial segment of Ford Explorers," says Lampe. In a letter to Nasser, he added: "We believe you are attempting to divert scrutiny of your vehicle by casting doubt on the quality of Firestone tires."

As the attacks mount, both companies are in danger of further damaging already smashed-up images. For Firestone, the risk is grave: If questions about the overall safety of its tires stick, its brand could melt down entirely. For Ford, renewed questions over the stability and safety of the Explorer—one of the company's best selling and most profitable vehicles—could drive consumers into the showrooms of its SUV rivals, of which there are plenty. "The only winners in this are going to be their competitors," says James R. Gregory, CEO of Corporate Branding LLC in Stamford, Conn. "When you start the blame game, it creates a vacuum in the mind of consumers. Only negative issues are going to fill up that space," he says.

Even without Lampe impugning the Ford Explorer's roadworthiness, there's no disputing that Ford has plenty of

EXPLORER SALES WEAKEN



care to ensure the 2002 Explorer would be free of defects.

And the Explorer isn't the only Ford vehicle with initial quality problems. Ford's Focus compact was recalled four times in its first year, and its new small-sized Escape SUV was recalled five times. Last year, those defects and resulting production delays

cost Ford more than \$1 billion in lost profits. In a new survey from J.D. Power & Associates Inc., Ford's quality ranked below average—and behind both General Motors Corp. and DaimlerChrysler. "It's not the scorecard I would like," I. Martin Inglis, vice-president of Fords North America, told analysts.

JAPANESE EDGE. Even without the recalls, Ford's market position has taken a beating. Its North American truck profits, which propped up its performance for much of the 1990s, are slipping amid a slowing industry and tougher competition. Worse, Ford is losing market share in trucks to GM, which has a strong new lineup of trucks and SUVs. And Japan's carmakers are challenging the segment for the first time with car-based SUVs such as the Toyota Highlander and Acura MDX. The Japanese have an added edge: A weak yen lets them keep their SUV prices down, putting pricing pressure on Ford and other U.S. carmakers.

That's pressure Ford doesn't need. To pay for the replacement

normal and has prompted analysts to predict further factory cutbacks.

It's all a colossal headache for Nasser, who has bet his career on transforming Ford from a mere manufacturer to a purveyor of automotive products and services that puts customers first. Firestone's charge that Ford is trying to hide its own safety problems behind the tire accusations could threaten all the work Nasser has done to enhance Ford's consumer image. But if Firestone can prove that charge, he's going to be looking at much more than a \$3 billion tire recall.

By Joann Muller, with David Welch and Jeff Green in Detroit and Nicole St. Pierre in Washington



"Our analysis suggests that there are significant safety issues with a substantial segment of Ford Explorers"

— JOHN LAMPE, Bridgestone/Firestone



quality issues of its own. The launch of the redesigned Explorer has been delayed. On sale only since March, the new Explorer has already been recalled twice. Though the recalls aren't safety-related, they are nonetheless enormously embarrassing to Ford, which took extra

campaign, Ford is taking a \$2.1 billion aftertax charge against its second-quarter profits and canceling plans for a massive stock buyback. And, amid such deteriorating market conditions, Ford's inventories are beginning to pile up on dealer lots again, despite a 15% production cut in the first quarter. In April, Ford's truck inventories ballooned to 85 days' supply. That's about 20% above

TECHNOLOGY

PALM'S MARKET STARTS TO MELT IN ITS HANDS

A lack of cash for new technology is paving the way for rivals

Just six months ago, Palm Chief Executive Carl J. Yankowski was flying high. The longtime marketing guru was at the helm of a company that owned the rapidly growing market for personal digital assistants. Consumers had snapped up 13 million units in only five years. Palm Inc. accounted for three of every four handhelds sold. And it licensed its operating system for a tidy sum to the likes of Sony, Handspring, and Nokia.

Now, the company that's helped organize the lives of the digerati could use some help itself. A series of management miscalculations, tough competition, and weak market conditions have left the company reeling. Sales have tanked, losses are mounting, and Palm is bleeding cash even as it must spend millions updating its technology to fend off a renewed challenge from onetime handheld also-ran Microsoft Corp. (page 74). Says CIBC World Markets analyst Tom Sepenzis: "This company got into trouble so fast it makes your head spin."

TAKEOVER BAIT? Worse, investors are fleeing, and the once dominant company looks increasingly vulnerable. Shares have plummeted more than 90%, from the high of 95.06, hit on Mar. 1, 2000, its first day of trading, to just 6.50. Some analysts believe Palm may now be takeover bait, with Apple Computer Inc. and IBM as potential suitors. What went wrong? Like much of the tech industry, Palm was caught off guard by last fall's slowdown. Coming off five consecutive quarters of triple-digit unit-sales growth, Palm revved up production in late November to meet what it thought would continue to be soaring demand.



SQUEEZED

Palm is struggling with layoffs, new rivals, and more than a 90% falloff in share price

But as consumers' worries began to build in January, sales of Palm's low-end models weakened. Worse, economic problems were compounded as rivals made inroads into Palm's grip on the market. Handspring and others, for example, have snagged consumer market share with colorful, low priced models.

A bigger problem is that handheld

makers using Microsoft's PocketPC operating system, such as Compaq's iPaq, began to win over business buyers with feature-packed devices that boast more power and better screens. After just one year in stores, the PocketPC-based devices have grabbed 26% of the U.S. market for handhelds running \$350 and up, says market researcher NPD Intellect.

That's the high-profit sweet spot of the industry—and continued erosion there could spell disaster for Palm. Last year, Palm made about \$150 profit on each sale of the top-shelf \$399 Palm V, compared with only \$26 for

\$149 entry-level m100 model.

Palm has created its own problems, too.

It stole thunder from Handspring's new Visor Edge, Yankowski moved up the announcement of Palm m500 and m505, which replaced the best-selling Palm V line, to March. But after the rollout was pushed back until mid-May, Palm sales fell off a cliff.

Now, Yankowski faces hard choices. He must trim ambitious growth plans and possibly sell part of the company. "We are taking a hard look at more or less dramatically changing our business model," he concedes.

Getting money is top priority. Palm started the year with more than \$70 million in cash, but analysts estimate that could drop to less than \$100 million by November. To beef up its banker, Palm hopes to recoup \$238 million selling the San Jose (Calif.) site it bought for a new headquarters. But even CEO Judy Bruner admits that "it's a very soft market right now." And given the troubles, the markets may be unwilling to provide financing.

Palm doesn't have much leeway. Adding to its technology woes, it canceled its acquisition of enterprise-software maker Extended System Inc. The deal would have given it a leg up in the corporate market for handheld-network software. Meanwhile, Microsoft committed to spending \$300 million on new technology to grab share.

For now, Palm says sales of its new m500s and m505s are again boosting U.S. revenues. But that may not be enough. Yankowski will announce plans in late June for returning the company to health. Until then, he admits, Palm "is a work in progress." True enough, but right now time is no ally.

By Cliff Edwards
Santa Clara, Cal.

VIVENDI FACES THE MUSIC IN THE WEB

Acquisitions have transformed it from laggard to online leader

With a roster of artists including hit makers such as Eminem and Blink-182, Vivendi Universal dominates the music business. Today, only one out of every four dollars spent in the U.S. on a CD or cassette goes to Interscope Records, Motown, or another of the labels Vivendi's Universal music unit distributes. But until recently, being the largest music company on the planet hadn't done much for efforts to sell music over the Net. Home to Sting, Sisqo, and Mary J. Blige was largely a no-show as many of smaller rivals signed on with Inter- giant AOL Time Warner Inc. That's now changing faster than a teenager's wardrobe. Over the last 12 months, Universal has spent roughly \$400 million purchasing roughly half a dozen sites in an attempt to build what looks to be the industry's largest music portal. Most recently, on May 1, it bought music Web site MP3.com for \$372 million. **ESSENTIAL** That's a lot of money maneuvering to position itself in a medium with no guaranteed profits. But with analysts estimating that consumers may one day spend as much as 25% of their music budget online and rivals making their own online bets, Universal does not want to be left out. "No one knows what the consumer will do for," says Edgar M. Bronfman Jr., Vivendi Universal's vice chairman. "But the potential is just too large for us not to try to realize it out." Given the uncertainties, Vivendi is hedging its bets by investing in several directions. Under the guidance of Bronfman and Chief Executive Jean-Marie Messier, it teamed up with Sony Corp., the second-largest music company, in

February to create Duet, an online music service set to be launched later this summer. It also purchased EMusic, an outfit that operates sites for *Rolling Stone* and *Downbeat* magazines, and bought up GetMusic.com, the second-largest music news and e-commerce site. With the MP3.com purchase, Vivendi's sites now draw an estimated 40 million users.

For all its dealmaking, what MP3.com brings to the table is clearly key to the

Vivendi Universal's E-Music Bets



strategy: an industry-approved technology for storing and streaming songs to customers' computers. "These guys really have the technology down, and they've done it in a way that's both scalable and consumer-friendly," says Bronfman, adding that Vivendi intends to start using MP3.com as its main music portal beginning this summer. It will also let folks stream music from Duet.

A major reason for Vivendi's sudden online interest is competition. Other music companies have been busy testing the online waters themselves. Last year, Bertelsmann invested in onetime pirate site Napster, which is struggling since being forced to find a way to legally sell copyrighted music. It may never again be the force it once was. A bigger threat may come from MusicNet, a group formed in April when Bertelsmann allied with EMI, Warner Music, and AOL. Those record labels now have access to AOL's 29 million subscribers, although AOL controls billing.

If nothing else, Vivendi's online audience gives it tremendous leverage in future deals. Whether other record companies distribute their music through their sites or Vivendi tries to strike its own deal with the likes of AOL, having so many customers gives it far more ability to call the shots.

Most industry observers figure the record companies will eventually have to strike deals with every credible Net outlet, much as they currently sell through Tower Records or Kmart. "People don't know what label is behind Aerosmith," says David Bench, an analyst with brokerage firm Arnhold & S. Bleichroeder Inc. "They want to go to a megasite that aggregates all the music." As it happens, Aerosmith is a Sony artist, part of the Duet family. Now, with one of the largest online music portals, Sony and Universal figure they may get you to pay to listen to them online.

By Arlene Weintraub and Ronald Grover in Los Angeles, with Carol Matlack in Paris

DUET

to be launched this summer, it will stream music from Sony and Universal musicians. Music downloads are expected later.

MP3

An online music store that allows its 14.2 million users to legally purchase, play, and store songs, including those they already own.

EMUSIC

Operates e-magazine sites Rollingstone.com and Downbeat.com, which draw 2.2 million readers combined.

FARMCLUB

Promotional site where unsigned artists can post music draws 900,000 users. Lets Universal discover and promote new talent.

GETMUSIC

Two-million-strong fan site sells clothing, videos, and the like. Includes chat rooms and interviews with stars.

COMMENTARY

By Mike McNamee

CLEAN UP, WALL STREET—OR THE FEDS MAY DO IT FOR YOU

Whom do Wall Street analysts serve? If you say “investors,” you probably think a “hold” rating means you should hang on to your shares. The fact is, for most big firms, research is just salesmanship, and stock ratings are tools to court investment-banking business. During the Internet boom, analysts out to win hot initial public offerings for the likes of Amazon.com and Priceline.com competed to set sky-high price targets and buried the stocks’ risks—giving investors no warning of the huge losses that lay just ahead. And it wasn’t just tech analysts who blew it: While the Standard & Poor’s 500-stock index was falling 14% during 2000, 99% of analysts’ ratings were “buy” or “hold.”

WHAT WALL? Increasingly, investors are on to analysts. And so are the Securities & Exchange Commission and Congress. To head off mounting political heat, the Securities Industry Assn. has sped up work on a voluntary code of conduct for analysts. The code, due just before congressional hearings in mid-June, will urge firms to rebuild the thin “Chinese walls” that are supposed to separate research and investment banking. It could also recommend that firms quit paying analysts bonuses based on the success of IPOs.

But a code drawn up in secret by industry insiders is hardly enough. The issue is credibility—in short supply on Wall Street these days. Investors and regulators should insist on a tougher code drawn up by outside experts and verified by outside auditors. That code should include detailed disclosures that say which analysts have helped sell the stocks they’re covering. And it should ban analysts from doing research on stocks they own. Otherwise, Wall Street leaves itself wide open to an investor backlash that could fuel stiffer regulation.



Analysts Need To Be Analysts

A new industry code will try to get them back to basics. But that means giving up several roles:

RAINMAKERS Analysts issue favorable reports before IPOs and when managers become eligible to sell their shares.

SOLUTION Bar analysts from sharing in investment-banking profits.

BLIND OPTIMISTS Last year, as the S&P 500 and Nasdaq swooned, 99% of all recommendations were “buy” or “hold.”

SOLUTION Require brokerages to distribute independent research.

SHAREHOLDERS Many firms let analysts own stock in the companies they cover.

SOLUTION Block analysts from profiting from companies they research.

Analysts have always been prone to conflicts. Research costs money, and firms expect analysts to pay their way by helping to sell stocks. But the Net IPO boom worsened what ex-SEC Chairman Arthur Levitt Jr. decried as “a web of dysfunctional relationships.” As Net stocks hit the stratosphere, analysts turned into cheerleaders to help investment bankers win IPOs.

Many even issued favorable reports—known within the industry as “booster shots”—around the time company managers became eligible to sell shares.

ACTION. Now, Acting SEC Chairman Laura S. Unger warns that analysts’ “blatant conflicts” are undermining confidence. And the House Financial Services Committee will hold hearings on whether analysts “are crossing the fine line between research and merchandising,” says Representative Richard H. Baker (R-La.).

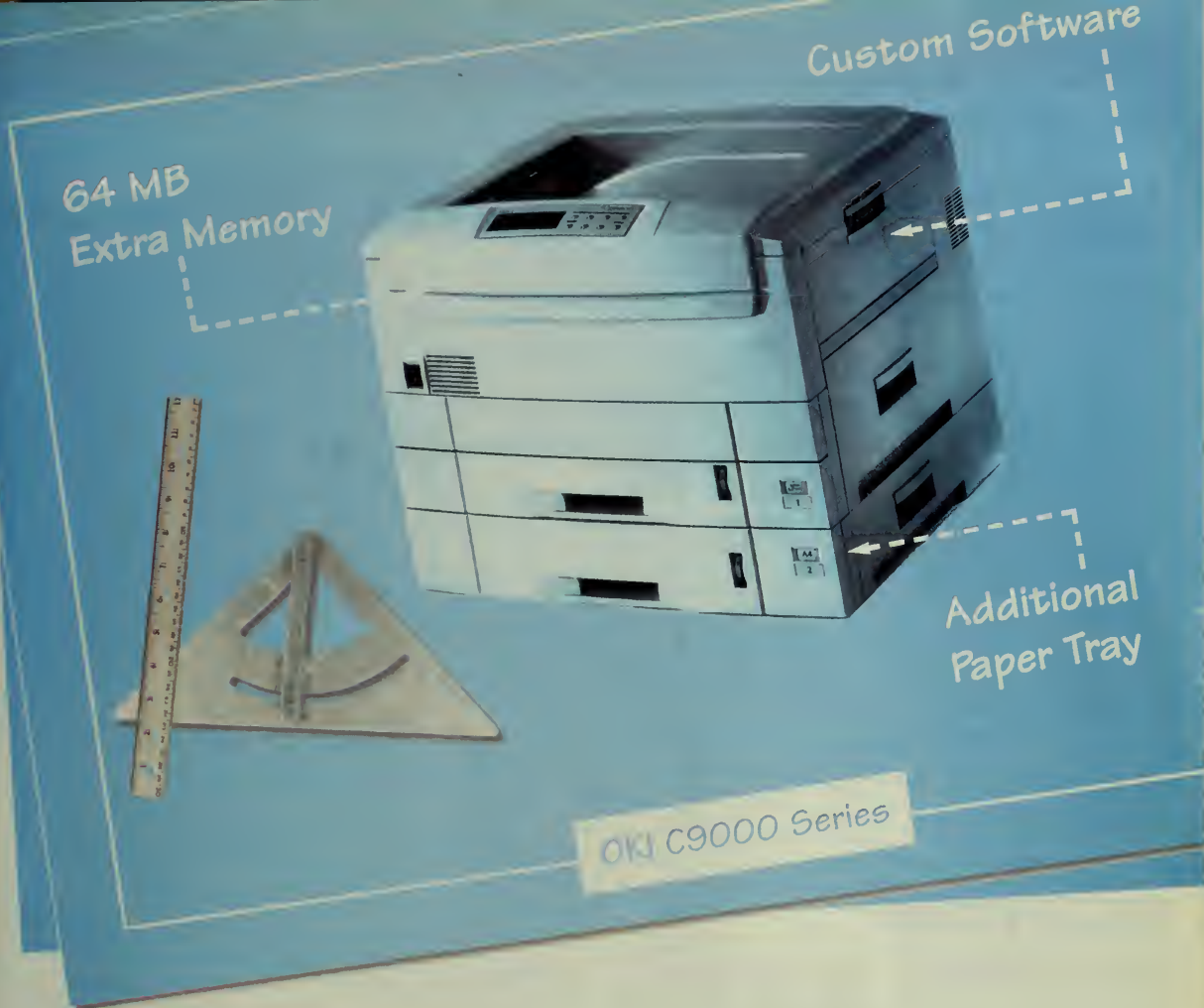
The SIA’s response: Push for release of Wall Street’s code. The panel is likely to recommend that research departments report only to top management

and that analysts’ bonuses be based on firms’ overall profits, not on the business they help bring in. But those steps, while worthy, aren’t enough. Merrill Lynch & Co. already separates its analysts’ pay and supervision from its banking arm. Yet its Internet analyst, Henry Blodget, is the poster boy for bulls who sent IPOs skyrocketing.

A better code is likely to come later this year from the Association for Investment Management & Research, a professional society that trains and sets ethical standards for analysts. Its task force on “research objectivity standards” includes institutions and individual investors with a stake in getting unbiased analysis. It is likely to argue for stricter rules on stock ownership, pay, and disclosure. And brokerages that claim to follow the code would have to submit to outside audits to prove that their analysts are above sales pressure.

Burned investors have learned not to trust analysts’ recommendations. So they’re hardly likely to take Wall Street’s word that it’s cleaning up its analysts’ act. Regaining credibility is the name of the game—and an insiders’ code of ethics isn’t the way to make that happen.

McNamee covers investing from Washington.



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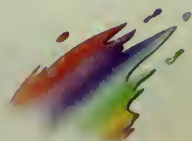
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EDITED BY ERIC SCHINE

JETBLUE: GO WEST, YOUNG AIRLINE

JETBLUE AIRWAYS, ONE OF the most successful startups in airline history, is spreading its wings. The 15-month-old carrier, with a hub at New York's John F. Kennedy International Airport, will create a new base for its low-fare service from Long Beach Airport near Los Angeles. JetBlue hopes to copy its successful New York strategy: serve a heavily populated area and gain a foothold at an underused airport. JetBlue received the 27 remaining open slots at Long Beach and has two years to use them. On Aug. 29, it will start service from Long Beach to JFK twice a day, with one-way fares ranging from \$129 to \$299, or more than 70% less than existing fares in the market. The air-

line, backed in part by financier George Soros, plans to expand Long Beach service to as many as 15 cities over the next two years.

THIS ADDRESS JUST GOT PRICIER

"YOU'VE GOT A PRICE HIKE" was America Online's morning greeting to around 20 million U.S. subscribers on May 22. In a widely expected move, AOL Time Warner's flagship online service said it was raising its standard monthly Internet access fee by \$1.95, to \$23.90, starting in July. It was the online service's first price increase in three years. The news buoyed AOL Time Warner's stock price on analyst forecasts that the move will add \$500 million in revenues the first year. Other Internet service providers are expected to follow market leader AOL's fee hike.

HEADLINER: ABIGAIL JOHNSON

FULL PLATE AT FIDELITY

WILL ABIGAIL P. JOHNSON have what it takes to make the Fidelity Investments money machine hum? On May 21, the 39-year-old Johnson capped a 14-year career at Fidelity by being named president of Fidelity Management & Research Co. The promotion puts her on the fast track to take over one of the country's largest private companies, worth at least \$40 billion, after her father, Chairman Edward C. "Ned" Johnson III, 70, eventually steps down.

Job No. 1: improving Fidelity's mutual funds, a unit with \$907 billion un-

der management. In 1999, Fidelity's U.S. diversified equity funds ranked a poor eighth among the top 10 fund families, and they ranked fifth last year, according to Morningstar Inc.

To get Fidelity back in shape, Johnson, a former stock analyst and manager of several Fidelity funds, may have to close some big funds while giving key fund managers more flexibility on where they can invest. She isn't giving out any specifics, but she vows: "I'll have my own mark that I leave on things, for sure."

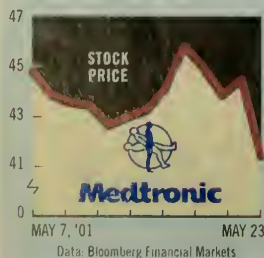
Geoff Smith



CLOSING BELL

HEART PROBLEM

Medtronic Inc. shares fell 6% on May 23, after it said its cardiac-defibrillator business had slowed. It made the disclosure in its fiscal fourth-quarter results, noting that annual sales growth of the devices, which treat fast heartbeats, had eased to 6%, down from more than 20% a year ago. Medtronic blamed a work backlog among doctors who install the devices. That has some analysts convinced that growth could pick up later this year.



BAD HAIR DAY FOR P&G

PROCTER & GAMBLE, SEEKING to rev up sales, disclosed on May 21 that it would buy Bristol-Myers Squibb's Clairol hair-care business for \$4.95 billion. P&G outbid Kao of Japan to enter the fast-growing market for hair-color products, where Clairol ranks No. 2. P&G would also get big shampoo brand Herbal Essences. But the company's shares fell 3% on the news, reflecting skepticism about the deal. While the acquisition would boost P&G's sales by 4%, it also would dilute earnings for at least a year.

SCRAMBLING THE DIRECTV PICTURE

WILL HE OR WON'T HE? Charles Ergen, the wily chairman of TV satellite company EchoStar, is hinting he will disrupt News Corp.'s bid

to buy General Motors' DirectTV service with an offer of his own. On May 22, Ergen said he would borrow \$1 billion to buy satellites and make "strategic investments and acquisitions." Ergen says a merger with DirectTV would be a "better fit," but skeptics think he just wants to force Rupert Murdoch to overpay for DirectTV's 11.2 million U.S. and Latin American subscribers. If a GM deal went through, Murdoch would merge DirectTV with News Corp. satellite holdings in Europe, Latin America, and Asia.

XEROX' SCANDAL: THE PLOT THICKENS

IT STARTED NEARLY A YEAR ago as a probe into an accounting scandal at Xerox' Mexico unit, and now the Securities & Exchange Commission is scrutinizing accounting practices at the copier giant's worldwide op-

erations. The latest allegations come from a former assistant treasurer, James Bingham who earlier sued Xerox for wrongful termination. Bingham has told the SEC that Xerox in 1999 sold future rental income to Citibank, netting revenues of \$142 million. That would equal 7% of Xerox profits in the second and third quarters of 1999, when the transactions allegedly took place. A Xerox spokeswoman says Xerox did not publicly report them because they were "not at a level that required disclosure."

ET CETERA...

- Goldman Sachs is letting go of 150 investment bankers
- Citigroup is dropping the name Salomon from its brokerage and investment banking units.
- Trendy shoemaker Steve Madden pleaded guilty to stock fraud charges.



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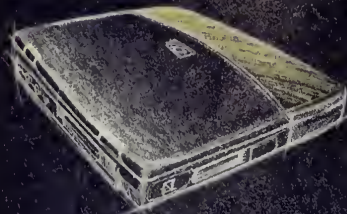
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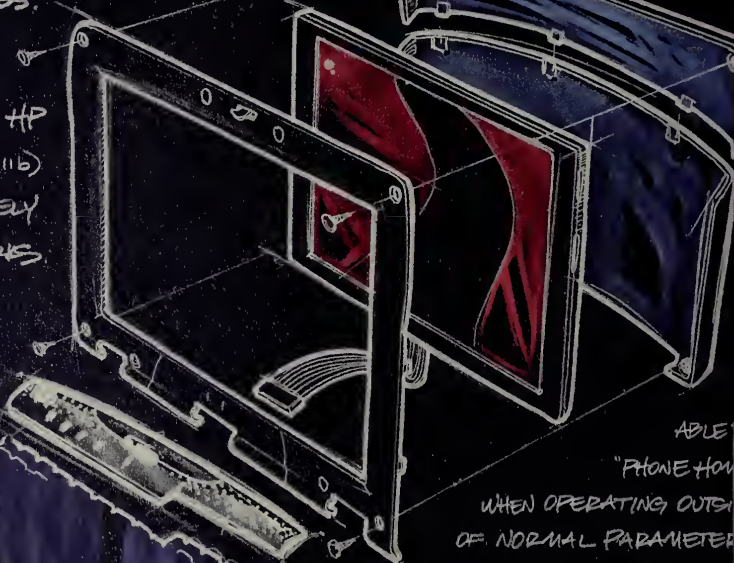


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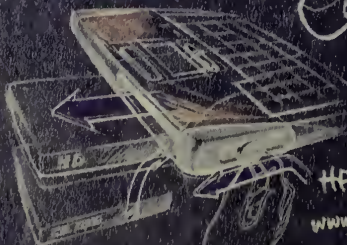
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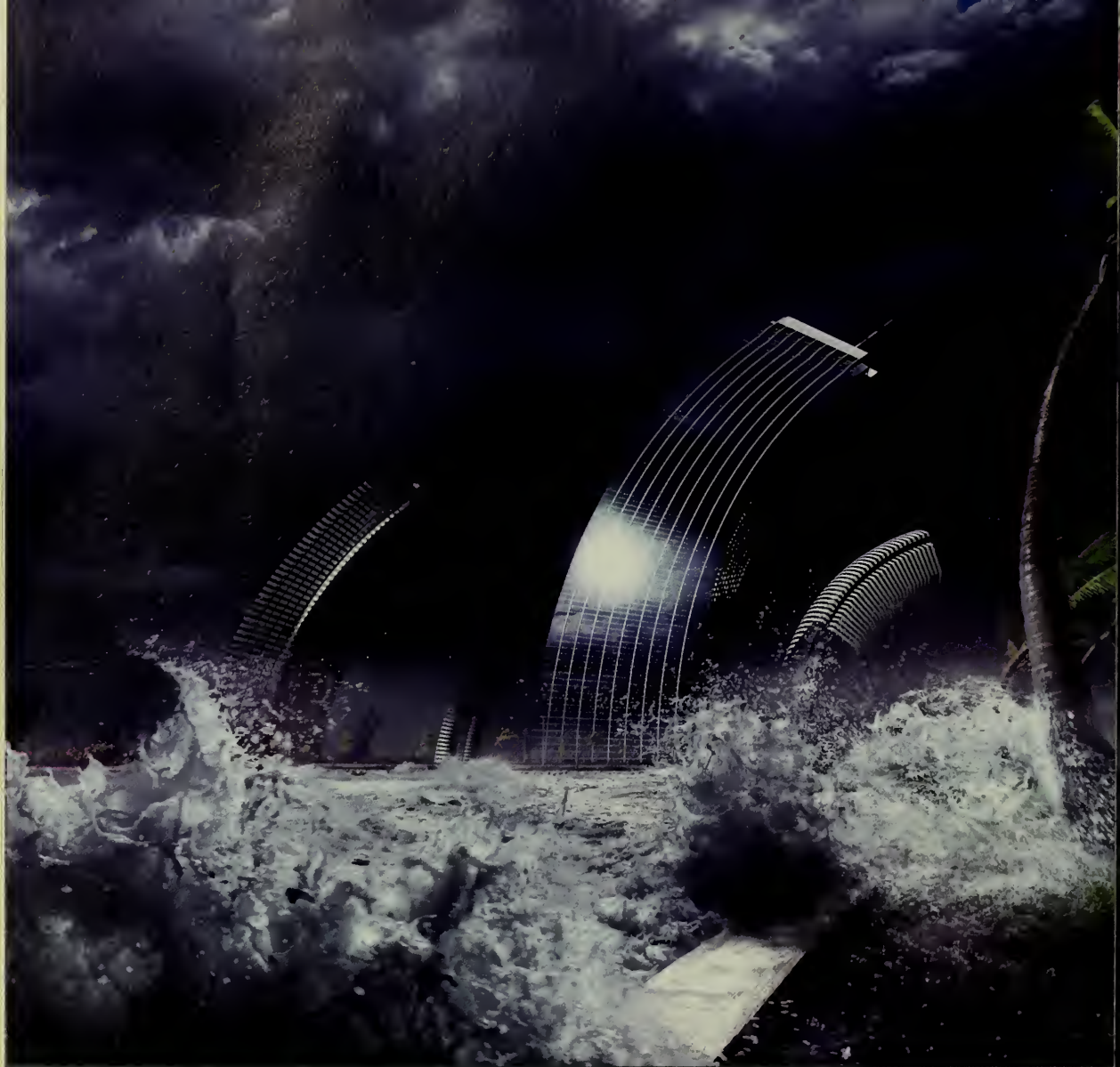




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EDITED BY PAULA DWYER

IN THE SHORT RUN, SWEETER DAYS FOR DEFENSE CONTRACTORS

As a candidate, George W. Bush portrayed himself as a radical on defense. He pledged to skip a generation of weapons and transform the military into a 21st century fighting force. Now, President Bush's Defense Secretary, Donald H. Rumsfeld, is reviewing the recommendations of 20 separate panels on how to overhaul the Pentagon. The process is weapons-makers and the brass in a near-panic over the fate of their pet programs.

However, the message from some of those close to the review process is: Relax. As much as Bush and Rumsfeld want to shake things up, the betting is that, in the short term, the biggest change can be summed up in two sweet words for defense industry executives and investors—more money.

GOOD NEWS. Bush is scheduled to lay out his administration's defense plans in broad themes at a May 25 commencement address at the U.S. Naval Academy in Annapolis, Md. But it could be a decade or two before the Pentagon achieves his vision of missile defenses, hyperfast, long-range bombers, and unmanned aerial vehicles. Right now, Rumsfeld needs to make investments to modernize aircraft, ships, and artillery, which in many instances the Clinton Administration allowed to deteriorate. That's why he may ask for an increase of up to \$40 billion in the proposed \$325 billion defense budget for 2002. "I see no inclination on the part of the new Administration to kill any major weapons program," says Loren B. Thompson, chief operating officer of the Lexington Institute, a think tank in Arlington, Va. "This looks like pretty good news for the defense industry."

While Bush has raised questions about whether the military needs to spend some \$340 billion on three new jet fighters, sources say all three are expected to get a green light. Lockheed Martin Corp.'s F-22 Raptor will soon go into production, and Boeing Co.'s Super Hornet will continue rolling

off the assembly line. A decision on which of the two companies will build the Joint Strike Fighter for the Army, Navy, and Marines is expected this fall. Not only will the winner get to make different versions for the three services, but the fighter could also be a big export item.

Rumsfeld's lofty new ideas largely focus on potential conflicts in Asia, where there are few air bases for existing short-range fighters. The beneficiaries include two contractors left on the sidelines during the industry's mega-merger wave: Northrop Grumman Corp. and General Dynamics Corp.

Northrop Grumman dominates the field for unmanned aerial vehicles, which would help limit casualties. And as the maker of the stealthy B2 bomber, it would be a contender if a new bomber is built. GD could benefit if the Navy builds more submarines and converts GD's Trident nuclear subs into conventional subs armed with cruise missiles. Missile defense would give a boost to Boeing, the prime contractor, and big subcontractors such as Lockheed Martin, Raytheon, and TRW.

In the near term, the biggest changes Rumsfeld may impose will be internal. He may alter how generals and admirals are selected. And Rumsfeld has picked three seasoned corporate executives as secretaries of the Army, Navy, and Air Force in a quest to squeeze more efficiency out of such operations as payroll and health care.

But it's unlikely they will squeeze enough money out to bankroll everything Rumsfeld wants. That means the Pentagon will be asking for a big share of the \$350 billion "reserve" left from the budget surplus after the Bush tax cut. With Social Security and Medicare also claiming those funds, Rumsfeld will have to sharpen his skills as a bureaucratic fighter to make sure guns—not geezers—get the cash.

By Stan Crock



RUMSFELD: \$40 billion more?

CAPITAL WRAPUP

McCAIN TAKES AIM AT THE NRA

► Senator John McCain (R-Ariz.) arrived in Washington in 1987 with strong financial backing from the National Rifle Assn. When he ran for President last year, though, he upset the gun lobby by promising to seek criminal background checks for buyers at gun shows. McCain is further alienating the NRA by teaming up with Senator Joseph I. Lieberman (D-Conn.) on a bill to make good on his pledge, which the NRA says will destroy gun shows. McCain is also ap-

pearing in gun-safety ads airing in 2,600 movie theaters in 44 states. Andrew McKelvey, founder of job recruitment Web site Monster.com, is bankrolling the ads. McKelvey last year started Americans for Gun Safety. It advocates stronger enforcement of gun laws and safer gun design.

HEALTH-CARE MUSICAL CHAIRS

► With Thomas A. Scully moving to run the Health Care Financing Administration, which oversees Medicare and Medicaid, his lucrative post as president of the for-profit hospital group,

Federation of American Hospitals, has become much sought-after. The leading candidate to succeed Scully, whose salary and benefits topped \$600,000, is Charles N. Kahn III, president of the Health Insurance Assn. of America. The loss of Kahn and his strong Republican connections—he had been the GOP staff director of the House Ways & Means health subcommittee—would mean the HIAA is more likely to merge with the managed-care group, the American Association of Health Plans. Talks between the two fell apart last year when small insurers balked.

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"My long-lost uncle dropped in for tea."

"A squirrel short-circuited the garage door."

There will always be plenty of excuses for not getting to work on time. But in the future, traffic may not be one of them.

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TELECOM

ALCATEL'S U.S. DREAM

Lucent was an idol—now it's a target

It has long been Serge Tchuruk's American dream. When France's natty Mr. Fix-it arrived six years ago at the formerly state-owned hodgepodge of businesses known as Alcatel, he knew a lot more about oil than fiber optics. But it didn't take Tchuruk long to single out one target, one vision of excellence, one symbol for everything France's Alcatel should aspire to be. It was a new spin-off from AT&T called Lucent Technologies Inc. That was the company Tchuruk wanted to benchmark Alcatel against. It seemed farfetched: Lucent was operating at the heart of America's Internet economy and was a darling of Wall Street and the home of legendary Bell Laboratories.

Alcatel? It was a work in progress, at best. Tchuruk, whose first move when he arrived in 1995 was to announce a \$5 billion loss, sold off scores of businesses, from vineyards to nuclear power, to focus on telecommunications equipment. He nudged researchers toward the Internet, pushed English as the company language. But catch up with high-flying Lucent? Not a chance.

RESCUE. Somebody go pinch Serge Tchuruk, because his American dream just may come true. The once-proud Lucent is now in trouble, a victim of botched management and bad bets. And it's Alcatel that's hurrying to Lucent's rescue. On May 22, the boards of both companies agreed to further consider Tchuruk's proposal: a \$34 billion stock takeover.

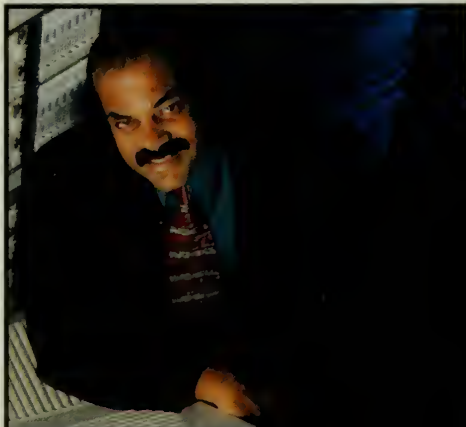
Make no mistake: This is a combination borne of weakness. Alcatel's an also-ran in the all-important U.S. market, and Lucent's sinking fast. Together, if this deal goes through, they have a chance to survive the coming shakeout. But riches or

domination? They're a long way off. Yet despite Lucent's many troubles, Tchuruk sees a chance to create a \$60 billion behemoth. Lucent holds 50% of the market in traditional switching equipment in the U.S., while Alcatel has 65% of that market in Europe. Combining the two would produce huge savings. "That combination alone is really exciting," says telecom equipment analyst Paul Johnson of Robertson Stephens.

But the heart of the combined com-

pany will be in the U.S., which accounts for 40% of global telecom spending. Most U.S. phone companies stick to two vendors, usually an entrenched supplier like Lucent or Nortel, and a friskier one with Net savvy—maybe Cisco, Juniper Systems, or Ciena. Alcatel, neither entrenched nor frisky, has only 22% of the U.S. market.

Now, instead of beating Lucent, Tchuruk's content to buy it. The payoff: access to long-distance providers such as AT&T and regional giants like Verizon Communications, which controls 30% of local lines in the U.S. Alcatel, having captured 90% of the U.S. digital subscriber line market, could bring some



GOOD UNDER FIRE?

Investors fear a merger could overtax COO Krish Prabhu and Tchuruk



FAST LEARNER

Tchuruk's background was in oil, but it didn't take him long to understand fiber optics

Scenes of a Marriage

The combined Alcatel-Lucent would be a global telecom powerhouse, but it trails rivals in some critical markets.

THE SKINNY

Lucent's U.S. foothold could provide new buyers for Alcatel's gear in this \$26 billion market—and vice versa.

COMPETITORS

Nortel, Siemens, NEC, Fujitsu
Combined Alcatel/Lucent market share: 50%

Cisco, 3Com, Efficient Networks
Alcatel/Lucent share: 33%

Cisco, Juniper, Nortel
Alcatel/Lucent share: 32%

Ericsson, Nokia, Motorola
Alcatel/Lucent share: 21%

Nortel, Fujitsu, Marconi, Ciena
Alcatel/Lucent share: 15%

Data: Dell'Oro Group, Merrill Lynch

VOICE

NET ACCESS

NET PLUMBING

WIRELESS

OPTICAL

Alcatel is No. 1 in the fast-growing DSL modem market, and Lucent's Ascend unit leads in dial-up Net access.

Neither Lucent nor Alcatel has gained success in Net routers, but the two own 60% of telecom data switches.

It's a potential \$500 billion market over the next decade. Nobody can afford to miss out.

Demand may be down for now in this \$25 billion market, but expect huge growth long-term.

ing to Lucent's product stable as well. The deal would also resolve the burning issue of who will replace Chief Executive and Chairman Henry B. Schacht, who came out of retirement to run the company last October after the board fired his protégé, Richard A. McGinn. The question is whether Lucent may be selling out too cheap. The stock, after all, is trawling near its historic low. The Alcatel deal gives investors no premium at all. "If I were on the board," says

Jeff Heil, director of equity investments for the Regents of the University of California, who sold 11 million shares of Lucent six weeks ago, "I would vote to bring in some new talent at the top and go it alone." If Lucent's board opts for this route—and analysts rate the chances 50-50—a host of new buyers could descend on the troubled company. These could range from Germany's Siemens to JDS Uniphase.

Though it's easy to see why Tchuruk is targeting Lucent, what a headache it would be for him to bring it all together. "This would be the largest tech merger ever," says Lehman Brothers Inc. analyst Steve Levy. And even if Tchuruk pulls it off, he's left with a titan in telephone technologies—but a laggard in the Internet and wireless businesses dominated by Nortel, Cisco, Ericsson, and Nokia.

Of the two, Lucent is in far more dire shape. The company is teetering under heavy debts and canceled orders. It announced operating losses last quarter of \$1.8 billion. By comparison, the \$27.6 billion Alcatel is faring just fine: At least it's still in the black, having eked out earnings of \$184 million in the first quarter, despite gaping losses in cell phones.

But Alcatel's relative health, paradoxically, is grounded in two weaknesses, its thinness in America and on the Net. Fact is, the U.S. tech distress has not yet crossed the Atlantic. It's thanks to the lag that Alcatel's market cap sits above Lucent's, \$37 billion to \$34 billion. This, along with his cleaner balance sheet, gives the 63-year-old Tchuruk the upper hand.

A bigger obstacle to Tchuruk nailing down a Lucent deal is more likely to be political than financial. Even the possibility of a French takeover of Bell Labs

is already stirring resistance in Congress. Senator Robert G. Torricelli (D-N.J.) warns that concerns over foreign control of "sensitive technology" could kill the deal.

EVIL TWINS. Alcatel investors are certainly holding back their applause for the deal. Since news of the negotiations filtered into the press on May 18, Alcatel shares have slid 6%. The concern is that the merger could overtax Tchuruk and his Texas-based chief operating officer, Krish Prabhu. And morale would likely sag. The companies compete in 75% of their offerings: Thousands of job cuts would be inevitable. "All of us will have evil twins somewhere in the organization," predicts one Alcatel engineer.

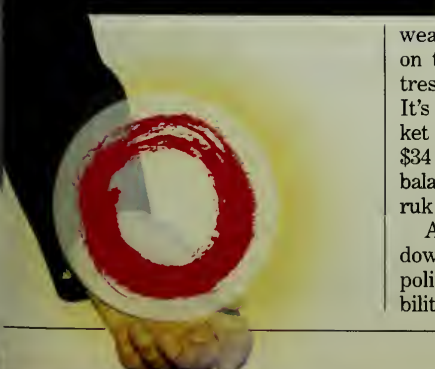
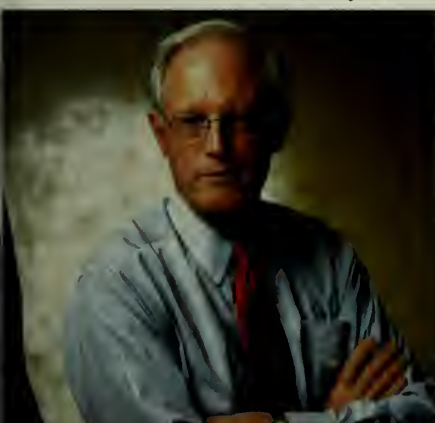
At least the merged company would be a focused global player, more American in character than French. That's because Tchuruk has been Americanizing Alcatel steadily since his arrival from oil giant Total Fina Elf. To get his piece of the Internet equipment business, Tchuruk spent \$17 billion for a handful of companies, most notably Xylan Corp., a networking company in Los Angeles, and Newbridge Networks Corp., a Canadian specialist in digital switches.

The deals taught Tchuruk a sobering lesson: The first instinct of American engineers, especially when dot-coms were still hot, was to run from a lumbering equipment maker, especially a European one. To hold on to his New Economy workforce, Tchuruk gave the U.S. subsidiaries wide berth and offered stock options. "We're not really a French company anymore," he said in a *BusinessWeek* interview last year. For Serge Tchuruk, America is the promised land. But even if he does pull off a Lucent deal, Tchuruk's work in the New World isn't going to get any easier.

By Stephen Baker in Paris and Steve Rosenbush in New York, with Andy Reinhardt in Paris

BURNING ISSUE

A takeover would resolve the question of who will replace Lucent CEO Schacht





SWITZERLAND

FORTRESS SWITZERLAND

An opaque, entrenched system is strangling growth

Bucolic, orderly Switzerland was never supposed to be like this. The shareholders meeting held on May 15 by Swiss travel giant Kuoni Reisen Holding looked more like a messy boxing match. Kuoni's vice-chairman, backed by a majority of the board in a bid to overthrow Chairman and CEO Daniel Affolter, sent in burly security guards to keep the company boss from taking his seat. In the end, Affolter was physically restrained as he tried to mount the podium, and was reduced to shouting. Now, the future of Kuoni's top management is murkier than ever, with Affolter claiming he is still legally CEO and the board insisting he's out. The dissident board claims Affolter and his wife illegally took money from the Kuoni family foundation—a charge Affolter denies. Lawsuits are flying, and another shareholder meeting is planned for early July to try and sort things out.

How un-Swiss. The Alpine confederation is home to sleekly run corporate giants like Nestlé, Novartis, and banking colossus UBS. But Nestlé and other paragons of corporate excellence are only half the picture.

The Kuoni case, along with similar examples of corporate strife at other companies, evince the dark side of Switzerland Inc. While the rest of Europe is moving toward more open cor-

porate governance, the message doesn't seem to be getting across in Switzerland. "Swiss companies have a lot of devices" to protect entrenched management, says Marco Becht, head of the European Corporate Governance Network in Brussels. "You name it, they have it."

That system worked well in the past—maybe too well. For one thing, Swiss corporations traditionally enjoyed easy access to capital, thanks to low Swiss franc interest rates and the huge Swiss banks that plowed some of their fat earnings into the local economy. With cheap bank funds available, many companies didn't have to worry about boosting returns to the highest level. "The result is that

many locally rooted companies are now having difficulties adjusting" to the global economy, says Winfried Ruigrok, professor of international management at Switzerland's prestigious University of St. Gallen.

That's the case with Sulzer Ltd., the conglomerate that dominates the eastern Swiss city of Winterthur. Management backed by the Sulzer family and other local clans, has pursued a diversification strategy in which shareholder value wasn't a top priority. Not surprisingly, Sulzer's stock performance has been lackluster. The company's main jewel, its 74% stake in Sulzer Medica, Europe's leading orthopedic company, is highly profitable. But its thinly traded shares sold at barely 15 times earnings, much less than those of competitors. The mother company, with \$3.3 billion in sales, was ripe for a takeover bid. Last year, Zurich corporate raider Renaissance Braginsky started buying shares and recruiting support from U.S. institu-

LITANY OF FAILURES

Kuoni May: Zurich-based travel group in turmoil as board moves to oust chairman and CEO

Roche May: Swiss investor Martin Ebner, failing to secure seat on Roche board, sells his 20% stake to rival Novartis

Sulzer April: Takeover bid fails for troubled \$3.3 billion industrial conglomerate

SAirGroup March: Parent of Swissair announces record \$1.7 billion in annual losses

Data: BusinessWeek

By Jack Ewing

TAKEOVERS: EUROPE'S HYPOCRISY

Chris Gent did shareholders of European companies a big favor last year. With his hostile bid for German mobile provider Mannesmann, the CEO of Vodafone Group PLC gave Corporate Europe a much needed kick in the pants. The message: Get your act together, or some raider will be after you.

Maybe it was just coincidence, but soon companies such as German chemical maker BASF stepped up efforts to dump noncore holdings, boost profits, cultivate investor loyalty, and drive up the share price. "Companies thought much harder about their own corporate structure," says one senior Frankfurt banker.

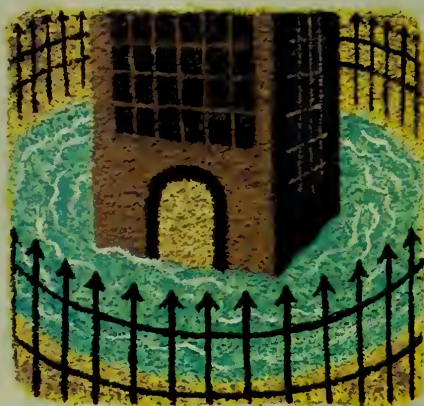
Unfortunately, the region's CEOs will soon be able to breathe easier. The European Union has failed to agree on takeover rules and may give up. Most alarming of all: Germany, Europe's biggest corporate powerhouse, is preparing to go its own way. The legislature is expected to pass a law that will expand the powers to fend off hostile bids through poison pills. The French, meanwhile, accuse the Germans of being spoilers, yet cling to arcane rules that grant disproportionate voting rights to privileged investors.

What CEOs in both nations have in common is hypocrisy. European managers always whine that tough labor rules make it hard to compete with fire-at-will America. They want workers to be good sports about getting laid off. Yet when their own jobs are on the line, the bosses want regulations.

RAIDERS. Case in point: A leading opponent of open takeover rules is the German Share Institute, a bastion of Germany Inc.—backed by companies such as Deutsche Bank and DaimlerChrysler. The institute argues that Germans already risk takeover by raiders while other EU partners, especially France, maintain barriers. The Germans point out that in 1998, they eliminated mechanisms giving some shareholders influence out of proportion to their holdings. Nevertheless, in France and other countries, certain

classes of shareholders still have more rights than others. "We don't have a level playing field," complains Uwe H. Schneider, professor of corporate and capital markets law at the University of Darmstadt.

Some of the Germans' thinking is valid. In the long run, though, it is not in their companies' best interests. As the fallout from Mannesmann demonstrated, the threat of takeover can be a healthy form of discipline. "I take the view that people who become tough in open markets are in a stronger position," says John B. Jetter, director of investment banking at J.P.



Morgan Chase & Co. in Frankfurt.

Things didn't have to turn out this way. A German takeover commission, featuring ex-Mannesmann CEO Klaus Esser and Munich management consultant Roland Berger, originally proposed that managers stay neutral in the face of takeover bids, letting shareholders decide.

Now, under pressure from business and labor, Chancellor Gerhard Schröder's government is expected to strike that provision. Esser, who should know, says managers can of course defend their independence, as long as they don't do anything that reduces shareholder value. That reasonable compromise should be adopted. Otherwise, Germany will fail to lead Europe in corporate governance. Globalization is good, it seems, until it threatens your own turf.

Ewing covers business and politics from Frankfurt.

nal investors. But Braginsky was unable to overturn the company's share transfer and voting restrictions or persuade local Swiss institutional shareholders to join in the assault. By April, Braginsky was forced to give up. Sulzer shares have slumped 30% since.

It has been a similar story at Basel pharmaceutical giant Roche Group. Because of a complex two-tiered vote structure allowing the descendants of founder Fritz Hoffmann-La Roche to maintain majority control with just 10% equity, Roche management successfully fought off Swiss financier Martin Ebner. Ebner and other shareholders argued that the structure depressed the stock price. But by mid-May, Ebner gave up, selling his 20% Roche stake to rival Swiss drugmaker Novartis.

INCESTUOUS BOARDS. A major problem is the incestuous nature of the corporate community. Some Swiss sit on 15 or 20 corporate boards; one Zurich businessman sits on more than 40. It's what the Swiss call *filz*—literally "felt material"—meaning the interwoven connections of a local community. And under Swiss law, a majority of board members of Swiss-registered companies must be Swiss national and Swiss residents. The result, says Gallen's Ruigrok, is that "boards rarely ask the annoying questions that management needs to be asked."

That, ultimately, was a recipe for disaster at SAirGroup, the holding company for Swissair. Under Chairman and CEO Philippe Brugisser, the group embarked on an acquisition binge of stakes in second-tier European airlines, including Poland's LOT and Belgium's Sabena. The move was a flawed strategy. But the board, composed mostly of political appointees and friends of Brugisser, never raised an eyebrow. By January, Brugisser was forced out—followed, three months later, by most of the board. Last April, it became clear just how close SAirGroup had come to going under when it reported a net 2000 loss of \$1.7 billion.

Will the recent debates force change in Switzerland? Some think so. "We are going to see a very strong movement now to be aware of the importance of corporate governance," predicts Gilbert Probst, head of the MBA program at the University of Geneva—and one of the independent board members of Kuoni. Already, notes Probst, independent audit committees are starting to crop up with some Swiss companies. But others are less sure how quickly the Swiss will change their system. In a national referendum in early March, after all, more than 77% of Swiss voters voted down proposals to start talks to enter the European Union. That suggests a lot of Swiss like things just the way they are.

By John Rossant in St. Gallen

JAPAN

HOW YAHOO! JAPAN BEAT EBAY AT ITS OWN GAME

It was first, and it was free. Can eBay Japan ever catch up?

Shigeki Ohya has a neat little sideline that earns him \$400 a month: selling Pez dispensers to Japanese kitsch collectors. The 32-year-old engineer for Nihon Texas Instruments in Tokyo buys the candy dispensers on eBay's U.S. site and sells them on Yahoo! Japan's online auction service. Why not do the whole transaction on eBay, which also has a Japanese site? Because Yahoo Japan makes eBay Japan look like a lightweight.

The contest isn't even close. Yahoo Japan has 95% of the online-auction market, where last year \$1.6 billion worth of goods was traded. By contrast, eBay Japan has a measly 3% of the Japanese market—even though its American parent rules online auctions in the U.S. Concedes eBay Chief Executive and President Meg Whitman: "We're definitely in catch-up mode."

If eBay doesn't boost its fortunes in Japan, that failure would imperil Whitman's plan to dominate global e-auctions. In April, she set a target of \$3 billion in worldwide sales by 2005, which requires annual revenue growth of 50%, up from 15% now. Whitman can't make those numbers without closing the gap in Japan, the world's second-largest Internet market.

eBay's first mistake in Japan was coming in late. And when eBay Japan did launch—five months after Yahoo Japan—it charged a commission for each transaction. Yahoo Japan doesn't. Not that the advantage will last. Yahoo Japan plans to start charging auction users a \$2.25 monthly fee this July and will add a commission on each sale later on. That may send customers to eBay. But for now, Yahoo Japan dominates Japanese online auctions.

Ironically, not so long ago, few thought online auctions would work in Japan. Even Masahiro Inoue, president and CEO of Yahoo Japan, thought status-



Going, Going...

YAHOO! JAPAN	EBAY JAPAN
STARTED September, 1999	STARTED February, 2000
REVENUE Auction site is free now, but starting in July, there will be a fee	REVENUE \$60,000 in its first year (est.)
UNIQUE USERS 2,746,000	UNIQUE USERS 227,000
TIME PER VISIT 2.5 hours	TIME PER VISIT 9 min.
LISTINGS 2.2 million	LISTINGS 3,500 (est.)

Data: Nielsen/NetRatings Japan, Deutsche Banc Alex.Brown, company reports

conscious Japanese wouldn't buy used goods from strangers. But nowadays, shopping in second-hand "recycle" shops is chic. Besides, Japanese are well-known fans of collectibles—think Pokémon—which are perfect fodder for the online-auction experience.

It was Jerry Yang, co-founder of Yahoo, which owns 32% of Yahoo Japan, who first got Inoue thinking about online auctions—and making sure eBay didn't steal a march in Japan. "Yang understood that it was critical to be first," says Inoue. "We knew catching up with

a front-runner is hard, because in auctions, more buyers bring more sellers.

In September, 1999, the site launched. To prime the pump, Inoue told his 10 employees to list items for sale. They needn't have bothered. Before long, thousands of collectibles, electronics, and brand-name goods were being traded. Today, the site boasts 2.2 million users. Nicholas Spratt, an analyst at Lehman

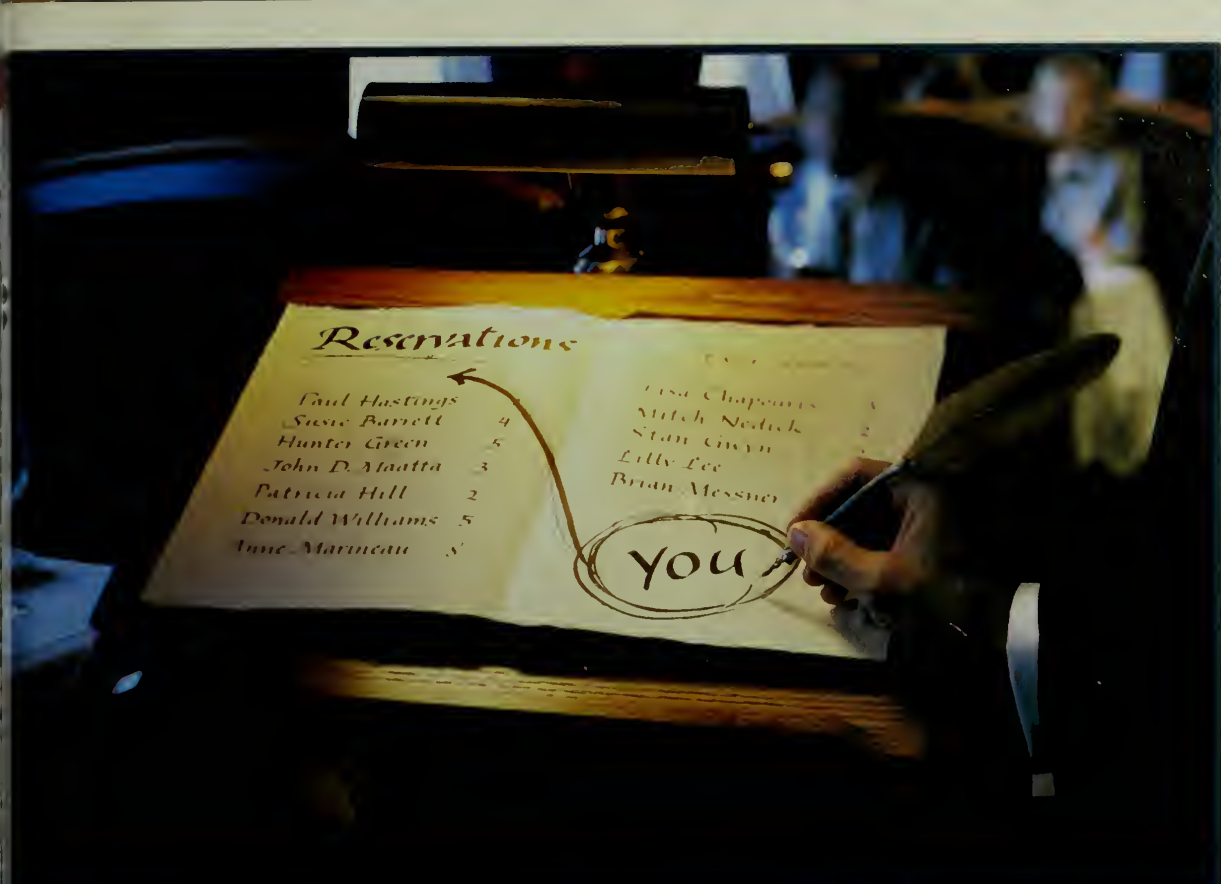
Brothers Inc. in Hong Kong, thinks the new fees could earn Yahoo Japan \$12.5 million, or 3% of revenues, this fiscal year.

By contrast, eBay's Japanese launch was hobbled by a series of missteps. The first was the decision to charge commissions of 1.25% to 5%. Another possible misstep was the choice of Japanese-American exec Merle Okawara as president and CEO. Okawara was a well-known in Japan for turning a faltering frozen-pizza business into a \$100 million company. But at 60, she was new to the Internet. Okawara, who is leaving the company, attributes the problems to the late launch. "When we arrived, the 80-pound gorilla was positioned **MORE MISSTEPS.** Even when eBay did get in gear, it took too long, critics say, to embellish its Japanese site with local touches needed to attract users. Nor did eBay bother to combat Yahoo Japan's major marketing blitz.

Still, eBay has the money for a long fight. The parent company had \$314 million in cash as of Mar. 31, and its stock had more than doubled this year. But throwing money around doesn't guarantee success: eBay has spent more than \$200 million to buy a Korean site, Internet Auction, and a European clone, iBazar. Yet both have combined revenues of just \$1 million last year, and analysts doubt that future results will justify the high purchase price.

Some analysts think eBay Japan should sell a majority stake in the venture to a big local player. But even then, eBay would face an uphill struggle. Okawara says the company's strategy to catch up with Yahoo Japan involves "patience." Adds Whitman: "We're in for the marathon, not the sprint." That's good. The race looks to be a long one.

By Ken Belson in Tokyo, with Ken Hof and Ben Elgin in San Mateo



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EDITED BY ROSE BRADY

THE MIDEAST: A GLIMMER OF HOPE AMID THE GUNSMOKE

Former Senator George P. Mitchell's long-awaited report on Israeli-Palestinian violence, released on May 21, could offer the two parties a way out of what seems to be an inexorably escalating war. But whether either will make serious moves to end the conflict is another question.

The Palestinians have called for a summit based on the Mitchell proposals. These include an immediate cease-fire, a crackdown by the Palestinian authority on local terrorists, and halt to Israeli settlement-building. Israeli Prime Minister Ariel Sharon sounded mildly conciliatory on May 22, talking of a compromise on the settlements, a key sore point. He also ordered Israeli forces only to return fire if shot at.

What happens over the coming weeks will depend on how much pressure the U.S. and European countries manage to exert on the Palestinians and Israelis. Events on the ground could also play a role. Another suicide bombing, for instance, could derail tentative efforts to reach a cease-fire. Most important, it's not clear that either military wants to back down. Palestinian leader Yassir Arafat is unlikely to heed calls for a crackdown on attacks on Israelis unless he gains something he can claim as a win. Sharon blames Arafat for the violence and will resist anything that smacks of rewarding him for it.

So unless a cease-fire is secured, the combatants on both sides will hold sway. The Israeli Cabinet has given Sharon, Foreign Minister Shimon Peres, and Defense Minister Benjamin Ben-Eliezer authority to sign off on military attacks without consulting the rest of the government. "The strategy means an immediate and continuous response to Palestinian attacks," says Gerald M. Steinberg, an expert on conflict at Bar-Ilan University near Tel Aviv.

The Israeli military seems increasingly to be calling the shots. The most vivid example of intensified military activity

so far came on May 18, when Israeli F-16 fighters bombed Palestinian targets in the West Bank and Gaza. On the Palestinian side, for all practical purposes, the agenda is being set by militant groups such as Hamas, which claimed responsibility for the suicide bombing that killed five people in the coastal town of Netanya that same day.

It's clear that the Palestinian Authority (PA), which is supposed to keep order, is on life support. The Israeli blockades have drastically reduced the local Palestinian government's effectiveness.

"If the current situation continues, then the Palestinian Authority will be unable to pay salaries within three or four months and will collapse," predicts Khalil Shikaki, director of the Center for Palestine Research & Studies, an independent think tank.

NEW TARGETS. Some analysts feel that is precisely Sharon's chief goal—to achieve the downfall of Arafat and the PA. As this line of thinking goes, if Arafat cannot control terrorist attacks, Israel has no use for him. The danger is that the Palestinian areas may come to resemble Beirut two decades ago, with gunmen and religious groups filling the vacuum left by ruined governmental institutions.

Arafat and his key aides can no longer be considered off-limits to Israeli attacks. That was the message of the May 20 shelling of the home of Palestinian Security Chief Jibril Rajoub. But this hard-line approach could eventually backfire. If the PA and its security apparatus are destroyed, extremists like Hamas are likely to have an even freer hand. And the possibility of any sort of lasting accommodation will recede even further. There will simply be no one to call. That's all the more reason for both sides to grab the lifeline that Mitchell and the international community are holding out.

*By Stanley Reed in London,
with Neal Sandler in Jerusalem*



SHARON: New power to attack

GLOBAL WRAPUP

CRACKDOWN IN CAIRO?

► Egypt-watchers are worried that the country's internal security establishment is gaining an unhealthy degree of power. The seven-year jail sentence handed down by a state security court to Saad Eddin Ibrahim, a prominent Egyptian-American sociologist, on May 21 adds to that suspicion. Ibrahim was jailed for a study critical of Egypt's election system. Some 27 other employees of Ibrahim's think tank, the Ibn Khaldun Center for Development Studies, also received sentences.

A professor at the American University in Cairo, Ibrahim is known for his efforts to promote democracy. Analysts fear that Cairo may be endangering relations with the U.S. and marring its reputation for tolerance by suppressing academics who appear to pose little threat to the regime.

NEW POLISH POLITICAL FORCE

► Poland's newest political movement, Civic Platform (CP), has proposed a radical program aimed at tackling the country's 15.9% unemployment rate. The center-right group wants to ex-

empt employers from paying Poland's 46% social security taxes for a year, as well as cut corporate and personal income taxes. The proposals are sure to influence debate in advance of parliamentary elections scheduled for Sept. 23. Founded five months ago by defectors from Poland's Solidarity and Freedom Union parties, CP enjoys the support of 18% of voters and is aiming to take the second-largest bloc of seats in parliament. The Democratic Left Alliance, with 40% support, is likely to win the largest share of the 460-seat assembly.

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STRATEGIES

CAN KRAFT BE A BIG CHEESE ABROAD?

It needs more global clout to offset a mature U.S. market

When Aussies stroll down the aisles of their local supermarket, what catches their eyes are snacks from Unilever and Nestlé. Kraft Macaroni & Cheese and Oscar Mayer hot dogs, on the other hand, are hard to find and far from first choice. "They would be classified as a low-moving line," says Terry Walters, the owner of an IGA store in Cairns, Queensland, about the classic American macaroni-and-cheese dinner. As for hot dogs: "We have the meat pie."

Kraft may be ubiquitous in U.S. grocery stores, but overseas it's a far different picture. Kraft isn't one of Walters' top five food suppliers, ranking below even H.J. Heinz Co., despite its ownership of Australia's famed Vegemite spread. Only 27% of its total revenues come from overseas, vs. 44% for Heinz, more than 50% for McDonald's Corp., and more than 80% for Coca-Cola Co.

That will have to change. As Kraft embarks on a giant initial public offering, expected in mid-June, its challenge is to once again become a growth company. Widely admired for the astute management of its brand lineup, Kraft is nevertheless stuck in a slow-growth industry in the U.S. Smart marketing and methodical cost-cutting helped it boost earnings 14.1% last year, but Kraft's sales actually dipped slightly, to \$26.53 billion. In fact, Kraft's annual sales have dropped 16.2% since 1994. The company took a big step toward

building revenues in December with its \$19.2 billion purchase of Nabisco Group Holdings Corp., whose cookie and cracker brands are growing faster than Kraft's top brands.

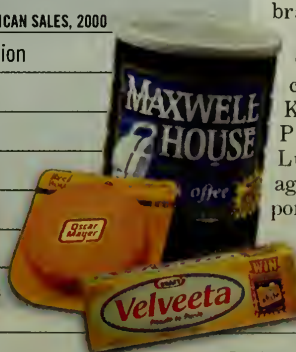
That deal should boost Kraft's sales to an expected \$35.05 billion this year. But analysts say that if Kraft is to spark long-term growth, it must do a better job of tapping foreign consumers. Kraft acknowledged as much when it announced that once the IPO is completed, Betsy D. Holden, CEO of Kraft Foods North America, will share the chief executive office with Roger K. Deromedi, a 13-year Kraft veteran who has been president and CEO of Kraft Foods International Inc. for the past two years. The company declined to comment or make top executives available to *BusinessWeek*, citing the quiet period before the IPO, as did parent Philip Morris Cos.

AMERICAN ICONS. The largest food company in North America by far, Kraft has dominated U.S. grocery-store shelves for decades. Its powerhouse brands are American icons: Philadelphia Cream Cheese, Oreo cookies, Tang, Jell-O, Kool-Aid, Life Savers, Planters peanuts, Lunchables prepackaged meals for kids. Its portfolio comprises a remarkable 61 brands with more than \$100 million in sales last year. Super-

What's Cooking at Kraft

CATEGORY	MAJOR BRANDS	NORTH AMERICAN SALES, 2000
CHEESE	Kraft, Velveeta	\$2.58 billion
COOKIES*	Oreo, Chips Ahoy!	1.69
CRACKERS*	Ritz, Premium, Triscuit	1.64
COFFEE	Maxwell House	1.21
COLD CEREAL	Post	1.20
COLD CUTS	Oscar Mayer, Louis Rich	1.03

*Brands acquired in December purchase of Nabisco Data: Kraft, Goldman Sachs





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market consultants say it would be nearly impossible to run a U.S. grocery store without its products.

But these aren't the best of times, even for strong supermarket brands. Shopper loyalty has waned as the grocery chains' in-house brands compete for shelf space, and big brands such as Kraft's tend to be mature. Take salad dressing. Even though Kraft is the market leader, "there's Kraft, there's Wish-Bone, there's Hellmann's," says John P. Mahar, operations director at the Green Hills Farms supermarket in Syracuse, N.Y. "If we have Wish-Bone on sale, shoppers pick up Wish-Bone. They don't care. The majority of Kraft's brands are just another commodity."

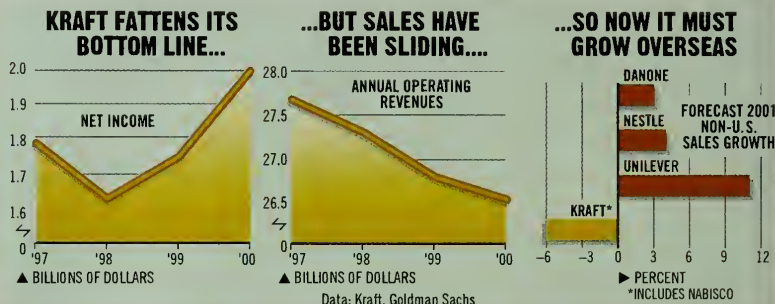
TOBACCO TAIN. Boosting sales will become even more urgent once Kraft has outside shareholders to answer to. Cigarette maker Philip Morris, which has owned Kraft since 1988, is putting 16.1% of the company on the market in an offering that could raise as much as \$8.4 billion. That would be the second-largest IPO on record, behind only AT&T Wireless Group's \$10.5 billion stock market debut last year. Philip Morris will remain firmly in control, but its goal is to realize more of Kraft's value by distancing the

business from the tobacco taint that has held Philip Morris' stock price down.

The first concern for investors might be whether Kraft's co-CEO structure can work. Deromedi, 47, and Holden, 45, who started at Kraft as an assistant product manager in 1982, will both re-

chairman and the board, which is controlled by Philip Morris, who will be the ultimate decision-makers for Kraft.

In this case, though, the co-CEOs have well-defined management areas. Another plus: Their personalities seem to complement each other. James J. Drury



port to Geoffrey Bible, chairman of Philip Morris. Analysts wonder how long the arrangement will last, citing a long list of prominent companies, from DaimlerChrysler to Citigroup, where co-CEO setups fizzled. "The co-CEO structure calls into question if this is truly an independent company," says Goldman, Sachs & Co. analyst Romitha S. Mally. "At the end of the day, it will be the

vice-chairman of Spencer Stuart, an executive-search firm in Chicago, describes Deromedi, who holds a math degree, as "more focused on problem-solving and more likely to make tough decisions in complex situations." Holden, he says, is creative, charismatic, and more people-oriented: "She's more the one to take into consideration how a business situation may impact people."

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A top task for the new CEOs will be figuring out how to expand outside North America. Overseas, Kraft faces a lineup of tough global competitors—Unilever, Nestlé, Groupe Danone—that were quicker to break into fast-growing markets in Asia, Latin America, and Eastern Europe. Unilever and Nestlé, for example, each get 32% of their sales in developing countries. Western Europe, Kraft's strongest international market, is almost as saturated as the U.S. Even in Great Britain, Kraft is only the eighth-largest food company. "A truly global organization would have a quarter to one-third of their business in North America, not three-quarters," says Adrian Richardson, global consumer and retail-sector head at BT Funds Management, a large money manager in Sydney.

FORTRESS. One problem is that Kraft's strength, convenience products, don't go over well in emerging markets, where scarce shopping dollars are concentrated on necessities. Unilever, for example, sells staples in India such as rice with added protein and salt with iodine. Kraft, on the other hand, has only a tiny presence there. But Kraft plans to jump-start sales in emerging markets by introducing additional snack, beverage, cheese, and other brands in countries where it already has a presence. It

also plans to enter countries where it has no operations and to make acquisitions, especially in snacks and beverages, according to its filings with the Securities & Exchange Commission. Richardson believes Kraft could make up to three significant acquisitions in the next few years to beef up its off-shore operations: "If they just build, build, build [new plants], they won't meaningfully move the dial," he says. For Kraft, "the U.S. domestic base is an absolute fortress that provides a very good cash cow" with which to go shopping. "They're not too late."

Close to home, Kraft is getting a much-needed shot of adrenaline from the Nabisco purchase. Last year, Kraft's sales dipped 1%, vs. gains of 7.3% at General Mills Inc. and 6.3% at Hershey Foods Corp. Many older Kraft products are in aging categories with flat or declining volumes, such as cereal and traditional store-bought coffee. But with Nabisco, Kraft picked up faster-growing product lines such as Chips Ahoy! cookies and Ritz crackers that will fuel earnings growth. Overnight, Kraft moved from a 6% to a 20% market share in crackers and cookies, a category that's expanding at more than twice the rate of the food-industry average. Goldman's Mally expects Kraft sales to rise 3.5% in each of the next three

years, just ahead of the industry average. And with the cost savings it expects to squeeze from Nabisco, Kraft estimates that its earnings will grow at an above-average 18% to 22% annually over the same period.

That additional growth will be needed to cover the cost of the Nabisco deal. The newly public Kraft will carry an \$18.5 billion debt load, even after using the offering proceeds to pay off a portion of the \$11 billion it borrowed through Philip Morris to buy Nabisco. Next year, \$7 billion of this debt comes due, and Kraft won't be able to meet that payment, according to its prospectus. But it says it plans to use its good credit rating to refinance.

Kraft has long been a leader in product development—in 1989 it launched the novel Lunchables line that's now a \$750 million-a-year product. Innovations like that put Kraft on top of the U.S. food industry. Now investors will be counting on Deromedi and Holden to sprinkle some of that magic overseas.

By Julie Forster in Chicago, with Becky Gaylord in Sydney

BusinessWeek online

For an investing perspective on the Kraft IPO, go to the May 22 Daily Briefing at www.businessweek.com.

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SHOTGUN WEDDINGS BY UNCLE SAM?

Bush would use federal funds to promote two-parent homes

CENSUS 2000

It came as no surprise when U.S. Census data released on May 14 showed the nuclear family in decline. Still, the striking numbers—married couples with children make up less than one-fourth of households—set off alarms among conservatives who ascribe a host of societal ills to the demise of the two-parent family.

President Bush, however, is already on the case. In a little-noticed twist on social engineering by government, his budget seeks \$315 million for programs that promote fatherhood and marriage. "Conservatives see a clear relationship between poverty and illegitimacy and lack of family formation," says Hudson Institute Senior Fellow Marshall Wittman. "You're going to see a big focus on dads in the Bush White House."

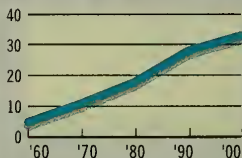
ESTRANGED. Conservatives aren't the only ones jumping on the fatherhood bandwagon. Senator Evan Bayh (D-Ind.), who chairs the pro-business Democratic Leadership Council, is sponsoring legislation to set aside \$380 million in block grants to the states to promote fatherhood. Among the bill's co-sponsors is Senator Joseph I. Lieberman (D-Conn.), and similar legislation introduced in the House has been endorsed by the Congressional Black Caucus. Community groups that provide counseling and support services to low-income fathers estranged from their children would be eligible for the funds.

Promoting marriage is not a novel idea: A handful of states now use money from federal welfare block grants to foster wedlock. West Virginia, for example, gives couples on public assis-

tance an additional \$100 a month if they marry. And some conservatives want to go further: When welfare reform comes up for renewal next year, they would earmark funds for programs like premarital counseling in inner-city schools.

One reason marriage figures prominently in the Bush agenda is Wade Horn, who is awaiting confirmation as Health & Human Services Assistant Secretary for Family Support. Horn created a private program in Maryland called the National Fatherhood Initiative and is a strong advocate of in-

OUT-OF-WEDLOCK BIRTHS KEEP RISING



▲ PERCENT OF ALL BIRTHS IN AMERICA

Data, *Making Room for Daddy: Fathers, Marriage, and Welfare Reform* by Wade F. Horn and Isabel Sawhill



tegrating marriage promotion into social services. For example, he would give married couples priority over single-parent families for benefits such as public housing and child care.

The paradox of throwing more money at fatherhood initiatives is that existing programs do not have a great track record of turning absent fathers into stable breadwinners. For example, in a 1998 study of one of the best-known

programs, Parents' Fair Share, which operated in seven cities using government and foundation funding, most of the men enrolled showed no improvement in ability to hold a job or pay child support. Nor did the program on average increase the amount of visitation between men and their children.

IN ARREARS. Horn and other fatherhood proponents counter that the shortcomings of Fair Share should not predict the success of future programs. Fair Share, he says, intervened too late to help the enrolled men, all of whom had substantial child-support arrears. The most auspicious moment to work with unwed fathers, says Horn, is around the time of the birth of their children, when almost half are cohabiting with their mothers. The theory is that persuading these couples to marry would help ensure a consistent paternal presence.

Existing research does suggest that as many as three-fourths of kids born to cohabiting parents will see their parents split up before they reach 16, compared with approximately one-third born to married parents. And children reared in two-parent homes do better on virtually every social indicator, from the

likelihood of living above the poverty line to finishing high school.

Wendell Primus, director of income security at the liberal Center on Budget & Policy Priorities, accepts that children are better off in stable, two-parent families. But he questions whether government can—or should—bring about marital unions. "I tell these guys 'You're the conservatives here. You've always said there are limits to what

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government can do," says Primus. "There is no evidence that what they want to do is effective."

Rather than promote marriage, Primus believes the best way to improve the odds that fragile families will stay together is reducing the economic stresses that plague indigent households. One example: the Minnesota Family Investment Program (MFIP), which allowed parents on welfare to continue to collect benefits as long as their earnings did not go over 40% of the poverty threshold, or about \$18,200 for a family of three. An unexpected outcome of the pilot program was that MFIP clients were more likely to get and remain married than people enrolled in the standard welfare system.

It's not just liberals who are skeptical about the marriage agenda. "I can't think of anything further outside of constitutional boundaries," says David Boaz, executive vice-president of the libertarian Cato Institute.

"THEIR DAUGHTERS"? Many directors of fatherhood programs also bristle at the idea of promoting matrimony. Instead, they say the focus should be on making their clients marriage material through counseling and job training. "I wonder if these conservatives would be so dedicated to marriage promotion if it was their daughters they were trying to marry these guys off to," says Robert Brady of the Young Fathers Program in Denver. "These men walk through my door with a lot of problems."

Joseph T. Jones, president of the Center for Fathers, Families & Workforce Development in Baltimore, doesn't wait for young fathers to come to him. Instead, Jones and his team get the names of fathers from women on welfare, track them down, and often make repeated efforts to enroll them in the program. "If we went in there talking about marriage... we'd probably get beaten up or shot," says Jones.

Not all longtime observers of fatherhood programs believe that forcing marriage onto the agenda is counterproductive, though. Ronald Mincy, a professor of social work at Columbia University, says that with out-of-wedlock child-bearing in the African American community near 70%, an aggressive approach might be needed. But marriage promotion cannot happen in isolation, Mincy cautions. Women are three times as likely to want to marry the father of their child if he holds a job, so helping these men become gainfully employed could go a long way toward fostering two-parent households. "I hope that the marriage agenda isn't imposed without the economic agenda," says Mincy. "That would be like telling the children of Israel to build bricks without straw."

By Alexandra Starr in Washington

Sports Business

COMMENTARY

By David Carter

BASEBALL'S OWNERS: NOW MORE THAN EVER A TEAM DIVIDED

Jimmy Dugan, the disheveled and disgusted manager that Tom Hanks plays in *A League of Their Own*, utters one of the all-time great lines about the national pastime: "There's no crying in baseball."

The whining, complaining, posturing team owners of Major League Baseball must have been out buying popcorn during that scene. There's no denying, though, that they have reason to bawl. Next season will be in jeopardy if a new labor agreement that addresses financial and competitive disparities cannot be hammered out between the end of the World Series and Opening Day, 2002. MLB Commissioner Bud Selig is hurriedly attempting to build a cohesive bargaining unit, but because the interests of team owners have become so much more diverse since the 1995 work stoppage, that could prove tougher to pull off than an unassisted triple play.

In years past, the debate has focused on narrowing the gap between small- and large-market teams. Now those two factions have splintered into several subfactions. For example, owners who are highly leveraged due to new ballpark construction—regardless of market size—might be more inclined to embrace players' demands because they can ill afford a shutdown. Among them are the San Francisco Giants, whose annual debt service is \$17 million.

Teams owned by individuals and currently in dire enough straits to be mentioned recently by Selig as possible candidates for relocation or elimination—such as the Montreal Expos

and Tampa Bay Devil Rays—would also be inclined to stay open for business since a work stoppage could be deadly.

In fact, the ability of some teams to ride out labor strife—especially those belonging to media giants, such as the Los Angeles Dodgers, Anaheim Angels, and Atlanta Braves—could make life miserable for the little guys. (That assumes, of course, that the shareholders of News Corp., Disney, and



ALEX RODRIGUEZ:
Midmarket star

DIVERGENT INTERESTS?

MLB ownership
keeps splintering

FACTION	EXAMPLE
HIGHLY LEVERAGED DUE TO NEW BALLPARK	San Francisco Giants
PART OF CORPORATE BEHEMOTH	Atlanta Braves
ON THE CRITICAL LIST	Montreal Expos
BIG-MARKET AND WEALTHY	New York Yankees
MIDMARKET WITH BILLS TO PAY	Arizona Diamondbacks

AOL Time Warner don't protest too loudly.)

The same can be said of large-market clubs that are part of sports empires, especially the rich-as-Midas New York Yankees.

For midmarket teams like the Arizona Diamondbacks, an impasse cuts both ways. On the one hand, going dark for any extended period of time would be painful. On the other,

they surely recognize that a failure to resolve financial disparities once and for all may result in their continually teetering on the financial brink. But theirs are the "swing votes" Selig will need to deliver a new collective bargaining agreement for Major League Baseball. Or should it be renamed the Major League Balkans?

Carter teaches *The Business of Sports* at the University of Southern California Graduate School of Business.



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BANKRUPTCY ON INTERNET TIME

Suddenly, many of those instant millionaires are out of work—and they're looking at huge bills

You might think that last year's tycoons were lounging on leather club chairs, sipping scotch with their private bankers as they chatted about the many options for their vast new wealth. Instead, some are sitting on the cold, hard benches of U.S. Bankruptcy Court, swilling machine-brewed coffee and wondering how things could have gone so wrong so fast.

It's the New Economy's latest form of whiplash—losing all your money nearly as fast as you made it. In high-tech hubs such as New York, Austin, Seattle, and San Francisco, lawyers and court officials say they see a rise in personal bankruptcy filings from among the people who until recently were celebrated for their killer career moves and financial savvy. Among them are former dot-com CEOs, high-tech programmers and engineers, and e-commerce marketing and sales execs, including about 25 Microsoft Corp. employees, some of them former millionaires.

UNRAVELED. Lenders are also noticing a doubling, to 10% of all filers, of "straights"—those who were paying all their bills one month and became broke the next, with no period of delinquency in between. These are the people, says San Diego lawyer Mark L. Miller, who "reaped the rewards of the dot-com boom, and now they're going down with the demise."

Some of these upscale types got stung by taking out high-risk margin loans to buy options or by locking themselves into luxury lifestyles, only to go broke once the shares

imploded. Others exercised their options and hung on to the shares, only to see them unravel—sticking them with huge tax bills on portfolios that are now virtually worthless. Then there are those in their 20s and 30s who charged up tens of thousands on credit cards—for vacations in St. Bart's, new wardrobes from Armani, and Italian furniture—only to get laid off without the cash to pay off even the monthly minimums.

The suddenly unwealthy are adding to a recent surge in personal bankruptcy filings, which in some jurisdictions have doubled in the past few months. After falling by 13% since 1998, national personal

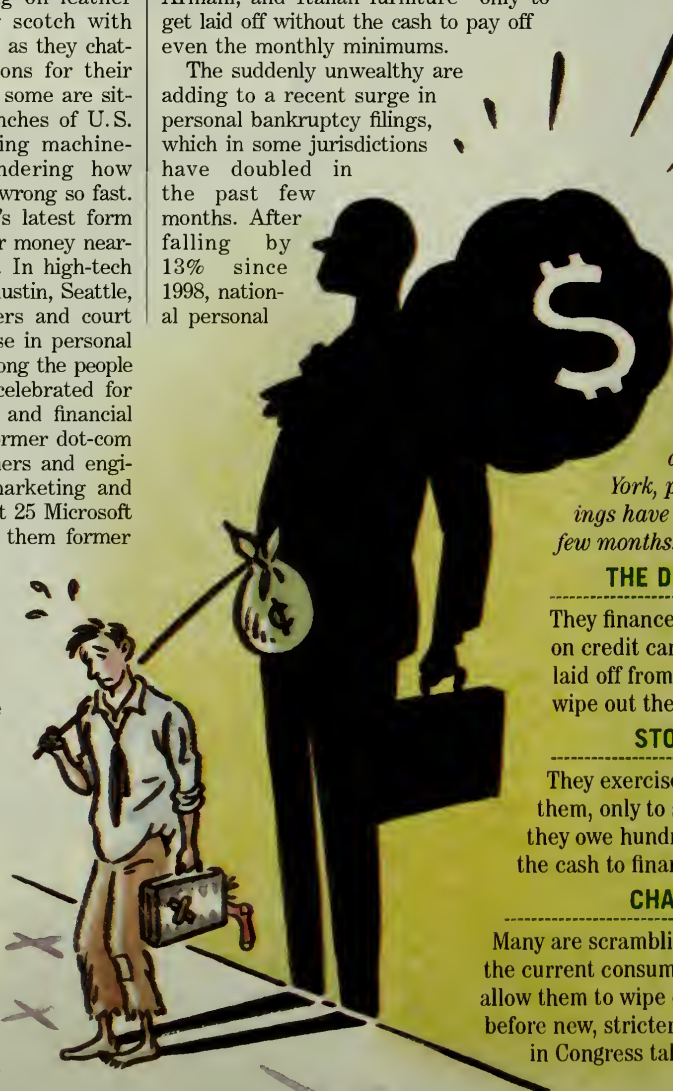
bankruptcies jumped 17.5% in the first quarter of 2001. That's almost back to 1997 levels, according to the administrative office of the U.S. Courts.

The surge has been sparked not only by the economic slowdown but also by impending changes to the bankruptcy law. The legislation, awaiting final tooling in Congress, is expected to make it more expensive and onerous for people to file, imposing new conditions such as means testing and debt counseling.

Many fear the new law will put even more pressure on the faltering economy since it will force more debtors to go into Chapter 13, under which they have to repay debts, as opposed to the currently more preferable Chapter 7, where many get wiped out. "If lenders get

more people back in Chapter 13, it will make them extend even more credit to marginal borrowers," predicts Mark M. Zandi, an economist at Economy.com Inc. "I'm not sure anyone will be happy with that."

Bankruptcy filings could also keep climbing as more people get caught in the



GOING BROKE

In high-tech hubs such as San Francisco and New York, personal bankruptcy filings have risen sharply in the past few months. A few key reasons:

THE DOT-COM HANGOVER

They financed their monied lifestyles on credit cards. Now that they've been laid off from dot-coms, they want to wipe out their \$50,000 bills.

STOCK OPTION HELL

They exercised shares without selling them, only to see stock prices crash. Now they owe hundreds of thousands and lack the cash to finance their other liabilities.

CHANGING LAWS

Many are scrambling to take advantage of the current consumer-friendly laws, which allow them to wipe out certain debts, before new, stricter laws under way in Congress take effect.

Data: BusinessWeek

up of the alternative minimum tax (AMT). A 1969 holdover created to ensure that the superrich wouldn't evade the IRS through tax shelters, the AMT is based on the paper gain accrued when stock options are exercised, even if they later lose value. But now, after stock prices have become a virtual currency, employees up and down the ranks, the AMT is catching all kinds of people in the net, including rank-and-file workers who hold shares that are now almost worthless.

That has put people such as Judy Pace, a 48-year-old single mother of two in San Mateo, Calif., in financial ruin. She owes the government \$334,000 in taxes on Broadvision shares that are now worth only \$100,000. "I'm in the middle class," says Pace. "This is very real." A bill to abolish the AMT has been introduced by Representative Zoe Lofgren (D-Calif.), but few expect it to pass anytime soon.

APORATED ENVY. So many whose fortunes have shriveled are racing to take advantage of today's more consumer-friendly laws. Some of the filers, according to San Francisco bankruptcy trustee Lynn Schoenmann, are young people whose careers and financial success used to inspire envy—people like Issam G. Kassab. Until six months ago, Kassab was grossing \$6,000 a month at a software company. But when he got laid off and was unable to find a new job, he found himself staring at \$48,500 in credit-card debt.

He's a far cry from the typical bankruptcy filer: uninsured workers or low-income families that went wild with a Wal-Mart card. Many of the new bankrupts were supplementing their ready-handsome salaries by selling stock options each month. When their companies' shares cratered, they were left without the cash to finance their \$500,000 mortgages, five luxury cars, and \$120,000-a-year property taxes in exclusive parts of Silicon Valley.

One such Silicon Valley couple, newlyweds in their early 30s with a baby on the way, had a net worth of \$35 million a year ago, according to their lawyer, Michael Malter in Santa Clara, Calif. But when the husband's high-tech company stock plummeted from \$50 to \$11, they ended up owing \$3.1 million in taxes on exercised options they held rather than sold, and which are now only worth \$1 million. Now they, along with a lot of others, are wondering if the New Economy's wealth machine will be remembered more for what it gave—or for what it took away.

By Michelle Conlin in New York, with Douglas Robson in San Mateo, Calif.

MEXICO

JOBS: WHERE MEXICANS ARE FEELING THE SQUEEZE

Companies step up layoffs as sales slow and margins narrow



President Vicente Fox is in spin-control mode.

Yes, he admits, with the U.S. economy cooling, Mexico is feeling a chill. "But from there to a crisis, there is really a world of difference," he recently told Mexico's top industrialists.

For a growing number of ordinary Mexicans, however, the crisis has already started. Top Mexican companies are cutting back their workforces to make up for falling sales and tightening margins. The trend began with export industries but is now spreading to sectors that serve the domestic market. Figures from Mexico's Social Security Institute show that the formal economy has shed 373,000 jobs since the end of November, when employment peaked.

The last few weeks have brought a steady flow of cutback announcements.

Construction giant Empresas ICA has let go of some 4,000 employees since the start of the year. Supermarket chain Comercial Mexicana intends to eliminate 500 positions, mostly through attrition. Broadcaster TV Azteca has axed 400 jobs and may take a swing at as many as 100 more. "We entered the year on a cautious

note," says Chief Financial Officer Luis J. Echarte. "It's easy to go ahead and crank it up, but it's hard to cut."

It's a sign of the times that Mexican businesses have moved quickly to shed staff. Publicly listed companies have become keenly aware that they are under scrutiny from investors, who often applaud layoffs as a sign of efficient management. "Mexican companies are beginning to react more like American companies. This is what they should do—take care of their costs," says Economy Secretary Luis Ernesto Derbez.

Even Fox has been forced to admit that job creation will fall woefully short this year. Mexico's economy grew only 1.9% in the first quarter, and the government is now forecasting that the full-year figure will not surpass 3%. That

WORK WANTED

Since November, at least 370,000 jobs have been lost

means Mexico will generate 400,000 new jobs this year—well below the 1.3 million needed to accommodate young people entering the workforce. Meanwhile, as

much as one-quarter of the labor force is underemployed.

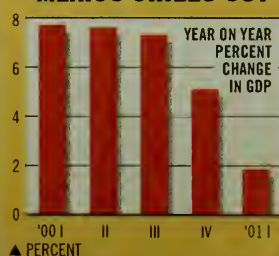
MIXED SIGNALS. Foreign investment may help put a floor on the job losses. DaimlerChrysler is plowing in \$300 million and adding 1,000 jobs at its plant in Toluca. Sanyo Electric Co. is spending \$10 million on a new cell-phone battery factory in Monterrey that will employ 900 workers by yearend.

The combination of bad news and good news has confounded Mexicans, who are forever bracing for the next economic meltdown. "This is going to be a typical slowdown, which for Mexico will be atypical," says Edgar Amador,

an economist at the Mexico office of Stone & McCarthy Research Associates. True enough: Companies are laying off simply because demand is slackening, not because the government is blundering into yet another crisis. But such distinctions are lost on those pounding the pavement.

By Elisabeth Malkin in Mexico City

MEXICO CHILLS OUT



▲ PERCENT

Data: National Institute of Statistics, Geography, and Informatics



MICROSOFT HOW IT BECAME STRONGER THAN EVER

The software Goliath has an arsenal of new monster products. Will the courts slow it down?

BY JAY GREENE

When 20,000 Microsofties streamed into Seattle's Safeco Field last September for the annual employee meeting, CEO Steven A. Ballmer knew he had to fire up the troops. It had been a stinker year for the software giant. Microsoft Corp.'s revenue growth had slowed to 8% from an average annual rate of 36% through the 1990s, a federal judge had ordered the company snapped in two for violating antitrust laws, and \$250 billion had evaporated from Microsoft's market value. Worst of all, with the Internet moving to the center of computing, PC pioneer Microsoft seemed on the edge of irrelevance.

So Ballmer dipped deep into his bag of motivational tricks. On a huge video screen, he played a clip from a documentary about the epic 1974 title fight between Muhammad Ali and George Foreman. Foreman, seven years younger, was expected to win. But Ali was the people's choice, and the 60,000 fans in Zaire that night broke into spontaneous chants: "Ali, *bomaye!* Ali, *bomaye!*" meaning "Ali, kill him!" Ali leaned back against the ropes and absorbed blows from Foreman on his gloves and his forearms but gradually wore him out. Fi-

nally, Ali pounced, sending Foreman to the canvas. As the video ended, the loudspeakers resounded with a new chant: "Microsoft, *bomaye!* Microsoft, *bomaye!*"

Like Ali, Microsoft had absorbed some bruising body blows in its own Rumble in the Jungle, Ballmer told the crowd. "We were getting shots from everywhere. Maybe we even had a little fear in our eyes." Then his voice suddenly rose to a shout: "You know what I say? I say we're off the ropes!" The Microsofties roared.

Back then, Ballmer's rallying cry was mostly wishful thinking. Now it's starting to look like an understatement. Not only do Microsoft's over-the-hill days seem over, but it is

Cover Story

emerging more powerful than ever. Instead of the Internet relegating Microsoft to the sidelines, the software maker has grown stronger in its core PC business, gained ground in the lucrative enterprise corporate market, and fought its way very nearly to the top of the Internet heap.

All the while, it has been making mind-boggling amounts of money. While competitors are pinching pennies in this harsher economic environment, Microsoft is awash in cash: \$30 billion, more than any other company in Corporate America. Moreover,

THE MONEY MACHINE

Microsoft is building on top of its huge and profitable franchises for desktop and server software by forging into such markets as game consoles, small-business software, and Web services. Its goal: To return to 20% revenue growth, up from 14% today.

THE CASH GENERATORS

WINDOWS Windows XP, the biggest update in five years, is set for Oct. 25. This version has a sleek look, is less crash-prone, and works better with the Web. The computer industry hopes the software, which has 97% of the market, could spark a PC buying wave. That could be tough in a saturated market and a slowing economy.

BUSINESS SERVERS

Microsoft is busting out of the low end of the server market with its powerful Windows 2000, which began shipping last year. Servers running Win2000 claimed 41% of the market last year, up from 38% in 1999, says market researcher IDC.

THE NEW BETS

.NET SERVICES

This technology lets unrelated Web sites talk with one another and with PC programs. One click can trigger a cascade of actions without the user having to open new programs or visit new Web sites. Microsoft hopes to use .Net to create Web services. First up: an alert service due next year.

XBOX Microsoft's leap into the \$20 billion game-console business begins on Nov. 8 with Xbox. Its game box will be three times more powerful than rival consoles by Sony and Nintendo. Microsoft plans to spend \$500 million in the first 18 months on advertising alone. But it may not be able to match rivals' game offerings.

it's adding \$1 billion a month to its bank account, thanks to its Windows and Office monopolies. That gives it the luxury to invest in other companies and spend lavishly on new business ventures while stoking its product pipeline—all crucial for extending its dominance. This year, Microsoft will spend \$4.2 billion on research and development, more than rivals America Online, Sun Microsystems, and Oracle combined.

Now, Microsoft is about to unleash the biggest onslaught of new products in its 25-year history. It starts on May 31

with the launch of Office XP, the latest version of its word processing and spread-

sheet program that accounts for roughly a third of the company's revenue. Next up, Stinger, a new operating system for cell phones, followed by Xbox, Microsoft's bold leap into the game-console business. And on Oct. 25 comes the big kahuna: Windows XP, a potent new version of its desktop operating system that Chairman William H. Gates III says is Microsoft's most important product since Windows 95. "We've never had a year with this many new products," he crows.

Windows XP is far more than just another spiffy rev of Windows software. With XP, Microsoft can finally harness its battery of products and Web sites, feeding customers from one product into another in a chain reaction with a potentially explosive result. Test versions of Windows XP in-

clude quick access to an easy-to-use browser that has a button that starts Microsoft's Windows Media Player. The browser zips you to Microsoft's MSN Web portal, which then offers simple ways to sign up for its instant-messaging and Internet mail service. What's more, Windows XP offers to plug you in to altogether new Internet services, such as Microsoft's alert system that e-mails or pages you when a flight is late or a stock dips low enough to buy.

HOOKS EVERYWHERE. Add it up, and Microsoft's ability to elbow aside rivals is staggering. Start with Windows. Analysts expect computer makers to sell 160 million PCs running Windows next year. On the Web, its MSN Internet-access service has 10 million subscribers. More than 50 million surfers hit its MSN portal each month. Its free e-mail service just landed its 100-millionth account. And its instant-messaging software is approaching 30 million users. Each product will feed on another. Its instant-messaging service will encourage users to sign up for Microsoft's Hotmail. Netizens who land on the MSN portal will be hawked to the access service. And Windows will push users to each piece of the empire. These hooks from one product to the next have rivals in a tizzy. "The threat that Microsoft poses is to turn the Internet into a company town—a Microsoft town," says Jonathan Schwartz, senior vice-president of corporate strategy and planning at Sun Microsystems Inc.

Nonsense, says Gates, the Web is too vast for one company to rule. He insists that the way he's handling Windows

Cover Story

If Passport's e-commerce software becomes ubiquitous

OFFICE The applications suite with the most than 10% of the market, plus a boost in new 32-bit with XP. It's going to be a better friend to the... MSN's advantage is... it may not catch a bid. Windows XP... back to the new app... will not end on the operating system.

MSN MSN is now one of the most trafficked sites on the Web. The msn.com portal ranks second in the U.S., behind Yahoo! Hotmail is the world's most used free e-mail service. And MSN Internet Access trails only America Online as the most popular way for consumers to hop onto the Web.

POCKET PC After years of false starts, the newest version of its tiny operating software for handheld devices is starting to eat into rival Palm's share. IDC says PocketPC should grab 19% of the handheld market by yearend, up from 10% two years ago. By 2004, that number could climb to 36%.

ALL BUSINESS This... Microsoft will enter the \$1 billion small-business ware arena. It bought accounting software specialist at Plains Software for \$1 billion in April. And it is to offer customer-relationship, human-resources, supply-chain software.

STINGER This is the latest iteration of Microsoft's software for cell phones. Stinger trials begin later this year with Vodafone in Britain, Telefónica in Spain, and T-Mobile in Germany. It's no slam dunk, with phonemakers Nokia, Ericsson, and Motorola backing rival Symbian.

ULTIMATE TV Launched this spring, it's a set-top box on steroids. The \$399 device not only lets people surf the Web and interact with TV shows but also record multiple programs on a hard drive for later viewing.

doesn't stifle innovation by others. "There's no block to people putting features on Windows," he snaps. Indeed, there are dozens of markets where Microsoft doesn't play, such as online stock trading and e-tailing. And Microsoft has had its share of dusts. Remember its Sidewalk hometown portals?

Instead, he sees the intertwining of Microsoft's products as a way to make the Internet a richer experience. His latest offerings bring Microsoft closer to the grand vision he has

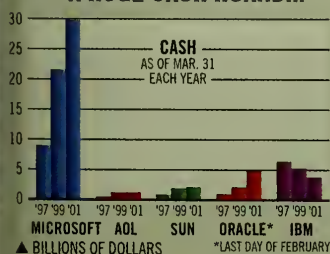
spun since he awoke to the Web six years ago. Gates sees a day when Microsoft software will run on any device, easily connecting people to the Internet wherever they happen to be. He's convinced that the way to achieve this "anytime, anywhere" computing is by weaving Microsoft's PC, server, set-top box, cell-phone, and handheld programs in with its Internet service technologies. Once that happens, Microsoft hopes to deliver software like a steady flow of electricity, collecting monthly or annual usage fees that will give it a lush, predictable revenue stream. "This era is one where we are certainly out front," says Gates, rocking in his chair with trademark intensity.

HOME FREE? If everything works as planned, Microsoft's software could be at nearly every point a consumer or corporation touches the Web. Since the Internet is now the backbone of most computing, that puts Microsoft at the center of all things digital. It's a huge turnabout for a company that was mocked for being late to the Net. "We're not playing catch-up," Gates says. "We're back in a pioneering position."

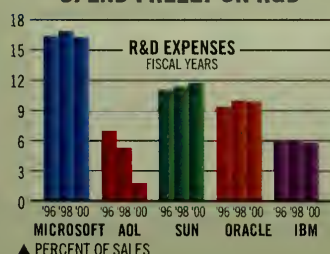
And, soon, Microsoft might not have a breakup order hanging over its head. The D.C. Circuit Court of Appeals is expected to rule any day now on the company's appeal (page 84). Based upon the questions asked at oral arguments,

MICROSOFT'S TREASURE CHEST

ITS MARKET POWER PRODUCES A HUGE CASH HOARD...



...ALLOWING IT TO SPEND FREELY ON R&D



Data: Standard & Poor's, company reports

Microsoft could become a tollbooth on the Internet



most legal experts believe the court will reverse at least one of Judge Thomas P. Jackson's findings: that the company illegally “tied” a browser into its operating system, that it acted illegally to defend its Windows monopoly, and that it attempted to divide the browser market with Netscape Communications Corp. If any part is thrown out, it's unlikely the breakup order will be sustained. Instead, the appeals court would probably send the case back to a lower court to determine remedies, which could trigger settlement talks. If the lower-court ruling is overturned, Microsoft is home free, pending an appeal to the U.S. Supreme Court by the state attorneys general who brought the suit along with the Justice Dept.

To competitors, there is no worse nightmare. It's as if the appeals court is about to unleash a hungry rottweiler in a steakhouse. In an effort to keep the collar cinched, rival AOL Time Warner Inc. has launched a clandestine lobbying campaign, warning Senate staffers about new threats to competitors and consumers. A presentation prepared for the meetings that was obtained by *BusinessWeek* calls Microsoft's Internet strategy “the boldest, most aggressive move in Microsoft's history to leverage their [Windows] monopoly to create a bottleneck that will constrict the Internet.” Says AOL Executive Vice-President Kenneth B. Lerer: “It appears they're doing all over again what they did when they previously went into foul territory.”

Sun Microsystems CEO Scott G. McNealy says letting Microsoft off the hook will stifle innovation. “We'll have to live with the consequences,” he warns. Already, many of the innovative Web software upstarts are in a mess, but of their own making. The Internet revolution promised a world where thousands of companies would flourish and the Web—not Microsoft—would be king, since it is built with industry-standard technology that everyone can use. The theory was that even while the antitrust case dragged on, market forces would keep Microsoft in restraints. But with the collapse of Net stock prices, the venture-capital well running dry, and not enough profits in the upstart's coffers, these would-be revolutionaries are hard-pressed to continue their fight. More than 400 Net companies have gone out of business in the past year. Many of those that remain have seen their stock prices sink by 90% or more.

“THEIR VIETNAM.” Microsoft is a study in the opposite. Even with the Nasdaq off 9%, its stock price has soared 60% this year, to 70, outperforming the rest of the Dow Jones industrials. The company bested analysts' expectations for the quarter that ended Mar. 31, earning \$2.45 billion on sales of \$6.46 billion. That led influential Goldman, Sachs & Co. analyst Rick Sherlund to add it back to his recommended list. “Microsoft has been playing defense for the last six years,” says Sherlund. Its Internet technology “is all about turning the tide and going on the offense.” Sherlund expects Microsoft to post revenue growth approaching 20% within a couple of years.

You can feel the old feistiness on the sprawling campus in Redmond, Wash. During the antitrust trial, Microsoft became an industry pariah, with only its most loyal partners coming to its defense. Burnt out or lured by the Net, about 20 top managers left, including Chief Financial Officer Greg Maffei and Paul Maritz, the architect of the new Net strategy. Microsoft often lost out on recruiting the brightest college grads. “It was their Vietnam,” says Roger S. Siboni, CEO of software maker E.piphany Inc. Now, the departures have slowed to a trickle. And Microsoft says that 86% of candidates offered jobs accept, vs. 79% during the dot-com craze. While industry stalwarts such as Cisco Systems, Yahoo!, and Dell Computer are laying off workers, Microsoft expects to hire 8,000 people in this fiscal year.

Still, the heavy lifting has only just begun. Much of Microsoft's success will depend on its ambitious Internet strategy dubbed .Net. This year, Microsoft will spend \$2 billion on .Net technology that will make it possible for unrelated Web sites to talk with one another and to programs on a PC. One click can trigger a cascade of actions without requiring the user to open new programs or visit other sites. The strategy relies on Microsoft persuading software programmers to use the technology, yet many tech companies still harbor a deep distrust of the company. At the same time, Windows 2000, its operating system for powerful server computers, has only begun to convince corporations that it's ready to handle the most demanding jobs. And to succeed as a Web services company, Microsoft will have to get consumers to pay, while most experiences on the Web are free. Fierce competitors await: AOL in the Internet market. Sun Microsystems in servers. Oracle Corp. in heavy-duty corporate software. And IBM everywhere.

The new Microsoft is once again like the old Microsoft: undaunted. “We want to keep the pedal to the metal,” says Ballmer. Indeed, Microsoft seems more aggressive than ever. Windows XP is where its bundling strategy notches up level. In test versions, when consumers start up a PC equipped with Windows XP for the first time, they'll see a host of changes making Microsoft products available with

“There's a buzz like we haven't had in a few years”

—CEO STEVE BALLMER

BILL GATES'S INNOVATION FACTORY

Critics say Microsoft doesn't come up with innovations that change the face of computing. Still, its engineers have hatched scores of modest advances that are in nearly every new Microsoft product. Moreover, promising projects are in the pipeline.

TABLET PC

Long a favorite of Gates, the first tablet PCs will hit the market next year. Microsoft has signed up five companies to make laptops with a screen to scribble on. While the handwriting recognition is still imperfect, Microsoft believes that buyers will use the devices to store handwritten notes.

NATURAL-LANGUAGE PROCESSING

The idea is to communicate with a computer the way you talk to a person. Already, users can retrieve info from Microsoft's SQL Server database software by typing in simple questions. The next version of Windows, due two years ago, will use even more natural-language technology.

or two clicks of a mouse. Consider the Passport service. Windows XP prompts consumers to sign up the first time they log on to the Web. If they agree, they'll be asked a series of questions about where they live, their e-mail address, their credit-card numbers. Rather than fill out a new form every time a Web surfer visits a site or submit a password on a site requiring it, Passport transmits the information directly, saving time and hassles.

Sounds pro-consumer. But Microsoft's enemies are por-



ing Passport as the Trojan Horse that could allow the company to dominate much of the Internet. Because of the software maker's incredible distribution power, opponents fear that Microsoft will be able to turn it into the ubiquitous payment and identity-authentication system on the Net. Microsoft already boasts 160 million Passport accounts. Although many of those are duplicates, this base of customers is only getting bigger, since 160 million new Windows PCs are expected to be sold next year. As sales grow, it will be easier for the company to convince Web-site owners that they ought to accept Passport. That, in turn, will trigger more consumers to sign up—the type of powerful cycle that winds up creating monopolies. That puts Microsoft in the position, if it

wants, to charge online merchants a fee for its Passport service. Although the company now denies that's the plan, its executives in the past talked about collecting fees for every e-commerce transaction.

Microsoft executives bristle at talk of Trojan Horses and the suggestion that bundling its Net services into Windows is unfair. "We have behaved consistently," says Ballmer. "We believe the law entitles us and encourages us to continue to innovate and add new capability. We thought that five years ago, two years ago, one year ago, now. We have not varied in our craft. We haven't stopped adding things to Windows."

Once you're a Passport member, you're set up to subscribe to a new set of services called Hailstorm. These include everything from notifying users of specific events to automatically updating their calendars when they purchase tickets or make an appointment online. Already, a half-dozen corporations have signed up, including No. 1 Internet auctioneer eBay Inc., which is building a service that instantly notifies customers when their bid has been trumped.

"ALL THE PIECES." Other companies are expected to engineer similar technologies for linking Web sites, but Microsoft has tremendous advantages. It can mobilize the army of 5.5 million Windows developers. It has an array of now-mature server software handling everything from e-commerce to databases. And it has Windows. "Microsoft has all the pieces to make this thing go, and no one else does," says analyst Ted Schadler of Forrester Research Inc.

Hailstorm is the next step in Microsoft's monumental switch from selling software programs to offering a vast array of services over the Web. Gates and Ballmer foresee a time when most of their revenues will come from subscriptions. In addition to Web services, Microsoft is retooling its software programs so they, too, can be rented out via the Net. Consumers will be able to buy a basic package of services: word processing, say, for a few dollars a month. Or they could shell out \$20 for a package that includes word processing, scheduling, and e-mail services, along with online storage to keep music collections and photos.

There's still a lot of packaged software to be sold, especially to corporations. Microsoft is just now becoming a major player in the upper reaches of corporate computing. For much of the past decade, Microsoft unsuccessfully tried to run the technical plumbing of huge organizations—the industrial-strength servers that kept corporate networks humming and handled their most important transactions. Windows 2000 Datacenter Server, released late last year, began to change all that. Now, J.P. Morgan Chase & Co. is running its commercial-loan processing system on Windows server software, and the electronic stock-trading network, Archipelago, handles 100 trades per second using Windows and Microsoft's database software. The market for Windows servers grew 32% last year, to \$13.9 billion, while sales of servers running rival Unix grew only 14%, to \$29 billion. The software impresses even former naysayers. "The giant is back," says Gary Bloom, the former No. 2 at Microsoft archival Oracle who is now CEO of storage software company Veritas Inc.

The key to winning more corporate

FACE MAPPING

Others are cooking up a way to use a digital camera to scan a PC screen and read into a 3D image. Microsoft then adds a full range of applications. The point? Microsoft thinks consumers will want to use their own PCs in role-playing games.

INFORMATION AGENTS

Researchers are creating software agents that help you sort through the deluge of electronic information. One day, an agent will study what types of messages you read first and know your schedule. Then it will sort e-mail and voice mail, interrupting you with only key messages.

THIS

IS THE POWER OF BUSINESS WEBS.

They said you were too slow.
Didn't understand the new economy.
But you waited.
Surveyed the scene like a field general.
And waited.
Saw the shakeout.
Maneuvered the troops.
They won't know what hit them.
This is the power of business webs.
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CHA-CHING.



bowstreet

“The game business happens to be one thing they know nothing about” —NINTENDO'S HIROSHI YAMAUCHI



business will be .Net. Microsoft aims to provide the technology that will turn Web sites and software programs into virtual

ego pieces. If it comes together as planned, companies will be able to snap sales, accounting, and inventory software programs together so that customer orders automatically update balance sheets and set off requests to replenish supplies. Today, each of those steps is handled separately. Microsoft is betting that customers will pony up for its server software and tools to build their own creations.

One of its first converts is Matthew W. Dunn, the chief information officer at Intrawest Corp., a Vancouver (B.C.)-based skiing operator with 10 resorts, including Whistler Mountain in British Columbia and Copper Mountain in Colorado. He wanted to set up a single Web site where skiers could book vacations to any of its resorts, arranging for lodging, lift tickets, ski rentals, and classes. But Dunn also wanted to tie those orders back into Intrawest's software programs that track customer relationships and accounting.

SLIPPERY SLOPE. It proved tricky. He ran into glitches with software from Oracle and e-commerce software maker Broadvision Inc. But using early versions of Microsoft's .Net technology and e-business software from Vancouver-based Pivotal

Corp., he got the system running in just 90 days. Intrawest booked about \$1.5 million

worth of business online last winter, even though about half of its destinations weren't tied into the new system for most of the season. With those properties available next season, Dunn expects the Intrawest site to generate \$10 million. Equally important, Intrawest is creating a customer database that tracks everything from the kind of lodging visitors like to resorts they have visited. With this data, it can offer customers special deals they're likely to find appealing.

With Microsoft's girth and need to grow quickly, there's hardly a sizable market it can ignore. Next up: programs for small and medium-size businesses. For years, Microsoft left that market to others, content that the accounting, human-resources, and procurement applications would run on top of Windows. Microsoft jumped in headfirst last December when it agreed to acquire Great Plains Software Inc. for \$1.1 billion. The Fargo (N.D.) company is a leader in finance and accounting software for smaller businesses. But accounting is just the first step for Microsoft. "It's good but not that interesting," says Jeffrey S. Raikes, group vice-president of the productivity and business services division. "Steve [Ballmer]



"WE'RE VERY PERSISTENT"

Xbox head Robbie Bach may have to eat considerable losses on the game console

is telling me to build the multi-billion-dollar business."

So Microsoft is cobbling together an entire suite of business applications that handles everything from accounting to customers to procurement. What

it doesn't build, it will buy, or it will partner with other software makers to fill in the gaps. This "suite" approach is how Microsoft conquered the market for desktop applications. Ultimately, Microsoft plans to plug these applications into bCentral, its small-business Web site, and offer the software as services. According to AMR Research, small and medium-size companies spent \$19.3 billion on software last year. "It's quite

HOW MICROSOFT MUSCLES INTO NEW MARKETS

1 Start with an existing monopoly. Microsoft controls desktop computing. When it ships its Windows XP in October, the product will be included with most personal computers sold.

2 Bundle a new service into your monopoly product. When consumers access the Web from Windows XP, they will be asked to join Passport, a service that packages their name, address, and credit-card numbers into a digital wallet. With Passport, they don't have to type in their vital data each time they go to a Web site.

3 Extend into a new market. By turning most PC users into Passport users, Microsoft hopes to build a large base of consumers using the service. That makes it attractive for more Web-site operators to adopt Passport for authenticating customer data.

4 Cash in. Once a large number of consumers and Web sites are using Passport, the company could be in a position to charge transaction fees for services based on Passport—such as alerts when a traveler's airplane flight is late.

A blue-toned photograph of two children laughing joyfully. The child in the foreground is wearing a light-colored shirt and has their mouth wide open in a laugh. The child behind them is also laughing, with their head tilted back. An adult's hands are visible, gently holding the children's heads. The overall mood is one of happiness and protection.

PROTECT YOUR CHILDREN FROM
AND VICE-VERSA.

The Odyssey



While it's impossible to childproof the entire world (that would require a lot of rubber corner-bumpers and outlet covers), you can



keep your children out of harm's way (and out of trouble) in a secure, reliable Odyssey. Protective parents will be pleased to know that the Odyssey did well on its report card. It earned an impressive quadruple Five-Star Safety Rating*—the highest rating possible. Even more reassuring, it comes equipped with childproof door locks, 3-point seat belts for all seven passengers and other features to help keep your kids under control. Which makes the world a safer place for all of us.

THE OUTSIDE WORLD.



“We’re not playing catch-up. We’re back in a pioneering position” —BILL GATES

compelling and quite frightening, I’m sure, in some quarters,” says analyst Dwight Davis of Summit Strategies.

Who should be scared? London-based Sage Group, for one. The niche software maker went *mano a mano* with Great Plains, a company its size, and did quite well. Now it faces a giant with the deepest pockets in tech. “Are they a gorilla? Absolutely,” says Sage CEO Paul Walker. He has confidence, though, in the ability of Sage’s products to succeed. But that’s what the execs at WordPerfect and Lotus thought when Microsoft set its sights on the word processing and spreadsheet markets.

Cover Story

Microsoft is tapping its war chest to attack new consumer markets, too. Take Xbox, the \$299 game console that Microsoft plans to launch on Nov. 8. Microsoft will spend tens of millions developing the box. And it plans to spend \$500 million more marketing it over the next 18 months, competing with Sony Corp.’s \$299 PlayStation 2 and Nintendo Co.’s \$199 Gamecube. Merrill Lynch estimates that Microsoft will lose \$800 million on Xbox in the next fiscal year. But with a \$20 billion market in its sights and with competing game consoles adding Web browsing and e-mail, Microsoft is running a marathon, not a sprint. “When we see a strategic need, we’re very persistent, we’re very committed,” says Xbox boss Robert J. Bach.

They’d better be. Although Xbox will deliver more than three times the processing speed of other consoles, it has a long way to go to match the competition’s hit games. Nintendo’s Pokémon and PlayStation’s Crash Bandicoot drive console sales. “Microsoft is an amazing company and Bill Gates is a great leader. But the people at Microsoft are not, and that means there are things they don’t know,” says Nintendo President Hiroshi Yamauchi. “The game business happens to be one thing they know nothing about.” **ONLY ONE TAKER.** Microsoft has stumbled before. Take interactive TV. In the past three years, the company has invested more than \$8 billion in cable companies to secure spot for its set-top-box software. But after nearly a decade tinkering with interactive TV, Microsoft’s set-top-box software is still hard to find. Only one cable company is using Globo Cabo in Brazil, which will begin a trial in 250 homes in Sorocaba later this month.

When Microsoft targets a market, it often perseveres. MSN portal and Internet-access service languished for nearly six years. Today, it’s the second-most popular portal on the Web, behind Yahoo! Inc. And its Web-access service is second only to AOL. Microsoft was able to dip into its war chest, vesting \$100 million in RadioShack Corp. and \$200 million in Best Buy Co. in exchange for those retailers promoting Microsoft access service—something smaller competitors can’t afford to do. “MSN, through an incredible war of attrition, has built

COMMENTARY

By Mike France

HOW MICROSOFT STAYS TWO STEPS AHEAD OF THE COURTS

Presidents come and go, antitrust policy waxes and wanes, and the Microsoft case gets passed from judge to judge. But one thing never changes: the company’s personality. Chairman William H. Gates III is still in charge, he still uses the same controversial techniques to expand his business, and he’s as aggressive as ever.

For evidence, look no further than Windows XP, the latest version of the company’s PC operating system, which is scheduled for release on Oct. 25. It’s a monopoly product. More than 95% of all PC buyers will get it. And it’s being packaged with a raft of Microsoft’s other products, including MSN Internet service, Windows Media Player 8.0, and the MSN Messenger instant-messaging service. The transparent goal: to push the vast installed base of Windows customers to use other Microsoft software as more and more aspects of their lives migrate to the Net.

This land grab raises an important question: Does Microsoft’s strategy violate antitrust law? Critics say yes. By weaving into the Windows interface software that other companies sell sep-

arately, such as its media player, they believe Microsoft is guilty of illegal “tying.” That’s the legal term used to describe a company that leverages a monopoly in one market into an adjacent area. Opponents also contend that Windows XP, when viewed in combination with Microsoft’s other aggressive actions, such as writing contracts that discourage PC makers from distributing rival products, could be construed as illegal monopolization. That’s when a company tries to kill rivals who threaten an existing monopoly.

NO VICTIM. Sound familiar? It should. These are the charges leveled against Microsoft in the current antitrust case. And they are the legal issues that will likely hang over the company for many years to come. Microsoft is committed to pushing its operating system ever outward, adding capabilities as new technologies emerge. And that means trustbusters are likely to keep monitoring whether the Windows behemoth is getting too big.

Whether a successful legal assault could be mounted against Windows XP depends, in large part, on how the Dis-

trict of Columbia Circuit Court of Appeals rules on the pending Microsoft case. This will mark the first time that a major appeals court has considered the application of tying and monopolization principles to the software industry. If the court finds that the government’s case was valid, then it probably wouldn’t be that hard to attack Windows XP.

But if, as expected, the appeals court takes a laissez-faire approach, then bringing a successful suit against Microsoft becomes much harder. Another factor could complicate any antitrust attack on Windows XP: the lack of an obvious poster child—a struggling young company like Netscape that is an innovative pioneer of the Web and faces destruction because of Microsoft’s conduct.

Bottom line: Reining in Microsoft could be an iffy proposition. Given the complexity and rapid changes in high-tech industries, most federal judges are “skeptical of [their] ability to make technological judgments,” says George Washington University antitrust scholar William E. Kovacic. “They’re unlikely to intervene in markets unless the

redibly powerful franchise," says Merrill Lynch analyst Henry Blodget. Microsoft shows the dogged persistence in it comes to basic research. Even while its latest products are waiting on the launchpad, it continues to pour money into R&D in search of the Next Big Thing. Gates is so jazzed about the future of software that he stepped down as CEO 18 months ago to become Chief Software Architect. That lets him spend more time with the company's 620 researchers. Walk through the warren of shoebox-size offices, and you'll find engineers working on the most vexing problems, such as getting computers to understand what you say. Gates gets wound up like a kid over stuff like creating a computer that watches your actions with a small video camera and determines if you're too busy to be interrupted with a phone call or e-mail. "The whole idea of valuing the user's time, that's the Holy Grail," says, jumping out of his seat with excitement.

Perhaps the most ambitious research foray is Microsoft's year-long march toward solving natural-language processing. It's a fancy name, but the concept behind it is simple and quite powerful. It's the idea that computers will be able to respond to questions or commands in everyday language, not computerese or a long series of mouse clicks. Combine that with speech recognition—another area where Microsoft researchers are plugging away—and one day you'll be able to talk to your computer the same way you do to another person. Microsoft has woven rudimentary natural language into

READY, SET...

Biz apps czar Jeff Raikes is shepherding the launch of several blockbuster products



such products as Office. The next step is delivering more advanced capabilities in the version of Windows due out in two years or so, code-named Blackcomb.

A lot of these markets remain a gleam in Gates's eyes. Time and again, though, Microsoft has shown it has the focus and the financial staying power to get it right eventually. That could mean we'll hear echoes of "Microsoft, *bomaye!*" for years to come.

With Mike France in New York, Amy Borrus in Washington, D.C., and Peter Burrows in San Mateo, Calif.



are highly confident that they have a good reason for doing so." Over the long term, if Microsoft's opponents want to defang Windows XP, their best bet could be to work on an argument that the Justice Dept. raised

in the antitrust trial: that the company is retarding innovation. In several briefs filed with Judge Thomas P. Jackson last year, the government argued that Microsoft was scaring rivals out of its path, thereby chasing away new ideas that could improve computing.

This reasoning impressed Judge Jackson, but it's still not widely accepted in the antitrust community. Why? Because Microsoft's XP operating system is clearly good for many consumers, who are grateful that the company bundles so many of the services they want into one easy package. Look for this debate—between consumer convenience, on the one hand, and innovation, on the other—to grow more urgent in coming years.

While the U.S. twiddles its thumbs over antitrust policy, Europe could take the issue into its own hands. Until recently, the European Commission let

Washington take the lead in policing the software maker. That's changing. European Competition Commissioner Mario Monti has become alarmed by signs that U.S. courts could turn lenient against the software maker. He announced an investigation in August. Instead of duplicating the Justice Dept. attack on Microsoft's dominance of the browser market, however, Monti has zeroed in on its attempt to corner the server market. He could expand his inquiry at any time.

DIRE CONSEQUENCES. This is no faint-hearted effort. Only one official is deployed in most EC antitrust inquiries. Against Microsoft, though, lawyers in Brussels say Monti has formed a "SWAT team" with more than half a dozen full-time investigators. Unlike the U.S., the EC isn't examining the possibility of breaking up Bill Gates's empire. But the European punishment could end up being quite severe—forcing Microsoft to reveal at least part of its Windows source code.

So don't be surprised if the Microsoft drama drags on for a while longer—in fact, quite a while longer. If regulators are to do much more than nip at Bill Gates's heels, it will take strong action in Europe or clear support in the U.S. for some of the novel theories raised in the Netscape case.

With William Echickson in Brussels

ILLUSTRATION BY CAMPBELL LAIRD; PHOTOGRAPHS BY ELAINE THOMPSON; AP/WIDE WORLD; CHRIS SCHRAECK/ZUMA PRESS

THEY'RE OFF! MERRILL'S CEO HORSE RACE

CEO Komansky is signaling that Stanley O'Neal is no longer a shoo-in to run the company



BROKER MADE GOOD

Komansky, who ran the brokerage side, gave O'Neal that job. It was thought to be a ticket to the top

It sounded like a sure thing. When Merrill Lynch & Co. Chairman and Chief Executive David H. Komansky promoted then-Chief Financial Officer E. Stanley O'Neal in February, 2001, to succeed John "Launny" Steffens as president of the company's army of 15,000 brokers in the U.S., the popular perception was that unless something went horribly wrong, O'Neal would be named next in line to run America's No. 1 retail brokerage.

And why not? For generations, Merrill has picked its leaders from among executives who proved their mettle leading its thundering herd. Komansky, who plans to recommend his successor to the board by January, 2002, before retiring in 2004, got his start as a broker. So did his predecessor, Daniel Tully. If he gets the job, O'Neal would be the first African American CEO of a Wall Street brokerage giant.

Now, however, O'Neal's ascension to the throne is in serious doubt. Both inside and outside the company, there is growing perception that O'Neal, 54, faces serious rivals. Jeffrey M. Peek, 54, head of asset management, is said to be coming on strong after resurrecting the firm's asset management division. Rumors are also swirling inside Merrill of two other possible candidates: the head of investment banking, Thomas W. Davis, 47, as well as the head of global private client services, Winthrop H. Smith Jr., 51, son of the first chairman of Merrill Lynch, Pierce, Fenner & Smith, as the firm was called when it was incorporated in 1959. "Stanley O'Neal is no longer a shoo-in," says Amy S. Butte, securities-industry analyst at Bear, Stearns & Co. "Jeffrey Peek is a serious contender."

Komansky has been sending conflicting signals of late. In an interview on CNBC on May 11, he said there are "at least three" contenders. And in other recent public appearances, he has praised businesses run by O'Neal, Peek, and Davis. Yet one senior industry insider says he heard Komansky say

ivate that although many names are ing floated, there is really only one ily suitable successor. Some close as- sociates say of late Komansky has ide favorable comments about ek, suggesting he may be pulling ead.

Since the CNBC interview, the ccession issue has become so nsitive that Komansky and the ntenders declined to be inter- ewed by *BusinessWeek*. "We ve a management succession ocess in place. David Komansky s said that he intends to make a ommendation to the board by the d of this year, and when a decision made, it will be announced," says npany spokesman Paul W. Critchlow. The growing uncertainty about Ko- nsky's successor couldn't come at a orse time. Although Komansky has hemently denied that any deal with itish private bank HSBC Holdings PLC in the works, renewed rumors of a tential merger have sparked specu- cation that Komansky is having trouble ding a successor from inside Merrill at the board will accept. Senior exe- cives on Wall Street, who ask not to be med, predict that Merrill may very on look outside for a chief executive, d could even draft Morgan Stanley's mer president, John J. Mack. Mack clines to comment on the rumors. "We ve a number of very talented people side the organization," insists itchlow.

IO AGGRESSIVE? O'Neal's path to the p might have been smoother had he en less aggressive of late in pursuing mbitious goals. Through cost-cutting, managed to dull the impact of rough arkets and boost his division's pretax argin by 2%, even though the U.S. ivate client group's pretax earnings d 2% in the first quarter. But it has st him the loyalty of some of his ops. One of O'Neal's first moves was announce 1,800 layoffs of support aff. More recently, he has encouraged nancial consultants to shuffle off clients th \$100,000 or less in investable ets to call centers. He wants okers to focus on clients with million or more in assets. at had brokers located in eas where there are few

THOMAS DAVIS

The investment-banking machine he runs now brings n two-thirds of the firm's earn- ings. Whether he has the leader- ship skills to run the whole outfit remains a question.



STANLEY O'NEAL

Proved as head of U.S. private-client services that he can strategize and cut ex- penses. But has ruffled the feathers of some of the firm's 15,000 brokers and must regain their loyalty.

year, Merrill funds have climbed to an estimated 35% of Merrill brokers' sales, up from 20% in 2000. "Stanley O'Neal has been and probably remains the leading candidate, but Jeff has made the decision tougher than it otherwise would have been," says Mark L. Constant, securities-industry analyst at Lehman Brothers Inc., who used to work for Peek at Merrill Lynch.

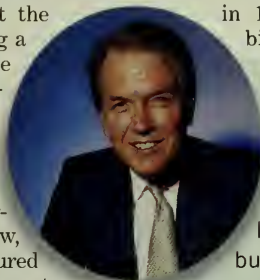
REMARKABLE RECOVERY. The other candidates have not had to prove their worth on rescue missions. But Davis has demonstrated his ability to lead investment banking, a business that accounts for 66% of Merrill's \$874 million in earnings in the first quarter. On his watch, the investment bank recovered from roughly \$1 billion in bond losses in 1998 to become the firm's biggest earner. "I wouldn't

millionaires to chase squealing in protest. Some brokers are leaving. "The rate of defections among Merrill brokers has accelerated recently," says Mark Elzweig, head of New York head-hunters Mark Elzweig Co. "This has been a welcome surprise to other wire houses. Merrill brokers were only rarely recruitable."

By contrast, Peek has been winning friends. He has spent the last three years transforming a major embarrassment for the firm into an asset. Since becoming head in 1997, he has revamped the asset management division and dramatically improved the overall performance of Merrill's own mutual funds. Now, 70% of Merrill's funds measured by assets are in the top quarter of their category, up from 40% over a year ago. Consequently, despite difficult market conditions, the division's pretax earnings declined by only 5% in the first quarter, and it experienced only \$73 million in net redemptions in equity and fixed-income funds, compared with \$1.5 billion during the same period of 2000.

Rival Morgan Stanley Dean Witter & Co. had \$444 million worth of net redemptions in the first quarter. "It's a real success story over the last year," says Whitney Dow, an analyst at Financial Research Corp., which monitors mutual funds.

More important, with improved product, Peek has been able to win the trust of many Merrill brokers. "In the past, some consultants would have been reluctant to use [Merrill's] products because of their performance," says Dow. But in the past



JEFFREY PEEK

The head of asset management energized the firm's once-lackluster mutual-fund business. Has to show he can apply the same skills to all of Merrill's business units.

count him out," says James F. Mitchell, securities-industry analyst at Putnam Lovell Securities Inc.

Although Smith, 52, is more of a long shot, he has built up a great deal of credibility within the ranks since starting with the company as an investment banker in 1974. He has also developed strong relationships with governments, institutions, and individuals everywhere from Tokyo to London as the chairman of Merrill Lynch International and president of its global private-client group.

For now, Komansky isn't under pressure from shareholders to rush to judgment. "We don't have a problem with any of the candidates," says Tom Goggin, portfolio manager at John Hancock Financial Industries Fund. But the longer the contest continues, the greater the risk that Merrill could be damaged by embittered losers.

By Emily Thornton in New York



BANKING

SANDY WEILL WANTS THE WORLD

The Banamex deal is just part of Citi's global push

Sanford I. "Sandy" Weill cheerfully admits he's no citizen of the world. "The biggest overseas move I ever made was across the river from Brooklyn to Manhattan," says the 68-year-old CEO of Citigroup, the U.S.'s largest financial services group.

Yet in the three years since Weill's Travelers Group merged with Citibank, he has taken his dealmaking skills abroad, supplementing the bank's century-old high end international presence with nearly a dozen more populist buys. On May 17, Citigroup made its most expensive international acquisition yet, the \$12.5 billion purchase of Grupo Financiero Banamex-Accival, the holding company for what will now be Mexico's largest independent bank and brokerage.

The deal, which Mexican President Vicente Fox hailed as a milestone for the country's development, underscores what's different about Weill's forays overseas. The bank's 1,353 branches cater to Mexico's middle class and small businesses, while its investment bank and brokerage serve the governments, top companies, and local elites that were the old Citibank's Latin American customers. One key to the deal's success, Citigroup management says, will be using the Banamex name to appeal to the 20 million ethnic Mexicans in the U.S. who send as much as \$8 billion home every year.

After the Banamex deal, 25% of Citigroup's \$14 billion annual

earnings will come from emerging markets, up from just 17% two years ago. Weill's international purchases represent a remarkable cultural and financial transformation for both sides of the Citigroup family. Travelers was an omnivorous buyer of domestic financial companies serving the middle and lower classes, but little of its earnings came from foreign sources. Citibank, on the other hand, was content to grow a top-drawer franchise abroad, and rarely bought a ready-made bank.

SHOPPING LIST. In the past 18 months, Weill's mid-market buying binge has changed all that. Citigroup has bought credit-card portfolios in Britain and Canada; Bank Handlowy, a Polish retail bank; a stake in Fubon Group, a Taiwanese financial-services group; and Associates First Capital Corp., a U.S. consumer finance company with a big Japanese presence—in addition to Banamex.

Citi is by no means abandoning



MEXICO

Citi's Banamex deal includes 1,353 branches. It will leave the bank's management in place



EUROPE

Acquisitions include Peoples Bank's card unit in Britain and Poland's Bank Handlowy



JAPAN

The purchase of Associate First Capital gives it a local footing in consumer finance

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high-end customers or its push to build Salomon Smith Barney, now renamed Citigroup, into a commercial and investment banking powerhouse. It bought Schroders PLC, a European investment bank, in 2000. And it is successfully campaigning to lure the rich and the prosperous middle classes in posterized Asia to its branches, some of which have been there for a century. Aftertax profits from the Asian retail business grew 60% to \$702 million last year, making Asia the fastest growing retail operation for the bank.

In an interview in his Park Avenue office—

which features a cardboard fireplace, a nod to the real ones in past offices—Weill says he wants Citigroup to be the most profitable player in any business that it's in, not necessarily the one with the biggest market share. And he wants to spread the full array of U.S.-style financial services around the globe. In Spain, Citi is recruiting nonprofessional agents to sell its Primerica financial products, Avon-style.

In Mexico, says Victor Menezes, Citi's head of emerging markets, the group hopes to build a consumer-finance business—which typically specializes in high-interest lending to people with poor credit—with the help of Keith Hughes, the former Associates CEO, who will serve as a consultant. It's an ambitious goal, and one that will require more than just the acquisition of a few branches. Central to Citi's highly profitable consumer finance business in the U.S. is a computer program that relies heavily on credit scoring, a practice that's in its infancy in Mexico.



DEALMAKERS

Rubin, Banamex's Hernandez, and Weill announce the deal in Mexico City. The purchase was Citigroup's largest abroad

Weill's plans to expand credit to the middle market through Banamex faces other hurdles, too. For one thing, Citi is competing with other international banks that may not have its left but have been there a lot longer. The Banamex deal, for example, gave Citi a slightly bigger market share in Mexico than Spain's Banco Bilbao Vizcaya Argentaria. But BBVA and archrival Banco Santander Central Hispano, which dominate the region, have made a science of buying retail banks in Latin America and making money from them.

Moreover, when volatile emerging markets hit a rough patch, the middle and working classes suffer most. And sophisticated financial services are the least of their concerns. In Argentina, caught in a debt crisis and a three-year recession, cash-poor consumers rely increasingly on barter. And in Turkey, a market Weill says he's eyeing, two financial-market crises and a devaluation since last November have sent small businessmen into the streets and dried up lending.

Analysts say that they've learned never to underestimate Citigroup. But they point out that the bank's international growth isn't matched by an expansion of top executives with foreign experience, with the notable exception of former Treasury Secretary Robert Rubin, now co-chairman. Rubin helped land the Schroders and Banamex deal, but much of the burden for the global push is falling on Indian-born Menezes. He worked abroad for Citibank for most of his career and is one of the few senior people left from the old Citibank. Now he's swamped: The Banamex purchase increased the number of employees reporting to him by 50%, to 82,633. Although the Mexican bank's management remains in place, Menezes will ultimately be responsible for the bank's credit risks and revenues.

HUMAN ACQUISITIONS. Former Travelers executives, meanwhile, are filling in. Jay Fishman, longtime head of the Travelers insurance division, for example, has been given responsibility for Japan and Western Europe. Weill insists that U.S. executives can get the hang of their foreign responsibilities, despite their largely domestic background. "I think it's great if you have the experience of living overseas," he says. "But you can learn a lot by listening to people, talking to people, and traveling a lot." Lately, he has quietly brought in some international brainpower. On May 17, the bank hired Marisa Lago, the U.S. Securities & Exchange Commission's former head of international affairs, as head of its "global workforce" and Richard Small, a former head of enforcement at the Federal Reserve, who will take charge of efforts to prevent money laundering through the bank.

Now that Citi has established a broader footprint in Latin America, the most dynamic economy, the question is: where next? Brazil, Turkey, and Korea feature predominantly on his radar screen, according to Weill. But

don't expect Citi to keep up the frenetic deployment pace, says the ever-diplomatic Rubin. "For most of our [future] growth will come organically, not from acquisition," he insists. Not Sandy has anything to do with it.

By Heather Timmon in New York, with Geoffrey Smith in Mexico City, Frederik Balfour in Hong Kong, and bureau reports

GLOBAL LAND GRAB

Citi's foreign deals cover the world

COMPANY/ COUNTRY	BANAMEX MEXICO	PEOPLES BANK CARD UNIT BRITAIN	ASSOCIATES FIRST U.S., JAPAN	FUBON GROUP* TAIWAN	BANK HANDLOWY POLAND	SCHRODERS PLC BRITAIN
DATE	MAY, 2001	APRIL, 2001	SEPT., 2000	MAY, 2001	FEB., 2001	JAN, 2001
PRICE BILLIONS	\$12.5	\$0.5	\$31.0	\$0.8	\$1.0	\$2.2
MAIN ASSET	1,353 retail branches in Mexico	220,000 European cardholders	500 consumer finance offices	Five financial- services groups	80 branches	European investment bank

Data: Company reports

July 4, 1939 Lou Gehrig



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EQUITY

THE PRODIGAL DOT-COMS' RETURN

Companies are buying back offspring, bugging investors

Two years ago, spinning off dot-com divisions looked like a dream deal to dozens of companies. They could raise cheap capital—and mine a vein of richly valued stock options to motivate key staff. “It allowed us to keep moving along with our Internet strategy without having to write a massive check that would dilute earnings,” says Thomas O. Staggs, chief financial officer for Walt Disney Co.

With Internet stock valuations in the basement, that dream has shattered, and many companies are reversing course. “Now, companies realize that their Internet divisions are not separate businesses at all, but just another distribution channel,” says Russell Miller, a partner at SCA Consulting in New York City. That’s why Disney bought back the Walt Disney Internet Group in March. Now, NBC, Staples, and Credit Suisse First Boston are all attempting to buy back their dot-com shares, mostly at prices far lower than they sold for originally. NBC, which sold shares of NBCi, its Internet division, at \$81.38, in February, 2000, hopes to repurchase them at \$2.19, while CSFB plans to buy back CSFBdirect, which went public in May, 1999, at \$20, for \$4. “They issued shares at a time when they got top dollar. Now that the experiment has failed they’re cleaning it up at very low prices. If I were a shareholder, I’d be pretty distressed about it,” says Jeffrey Haas, professor of securities law at New York Law School.

Some dot-com shareholders are incensed enough to sue. When Credit Suisse Group bought Donaldson, Lufkin & Jenrette Inc. last year for \$12.4 billion, a 36% premium, it didn’t purchase the shares of DLJdirect, later renamed CSFBdi-

rect. Instead, it left 18.4 million, or 18%, of the shares of the Internet brokerage in public hands. “What we have alleged was that DLJ’s board of directors knew it would be detrimental to the stock going forward, and they had a fiduciary responsibility to include the tracking stock as part of the deal,” says Laurence D. Paskowitz, of Abraham & Paskowitz in New York, representing shareholders in a class action. CSFB is offering \$4.00, a 60% premium to the \$2.50 close the day before the repurchase was announced

in March. But that’s still 64% less than DLJdirect’s \$11 close the day before it announced it was buying DLJ in August. CSFB executives declined to comment.

NBC, part of General Electric, offered a 66% premium on Apr. 9, \$2.19 for NBCi’s shares, which closed on the previous trading day at \$1.32.

But it is currently being sued by shareholders for a breach of fiduciary duty over the proposed buyback. NBC says it will contest the suit vigorously. Martin J. Yankovitz, president of NBC Digital Media, which created the NBC portal, defended the company for trying. “I thought the economics of the sector might be the brightest of all,” he says. Instead, “the portal sector turned out to be one of the weakest. It simply didn’t have a viable business model.” NBC plans to integrate its Internet division with its other entertainment businesses.

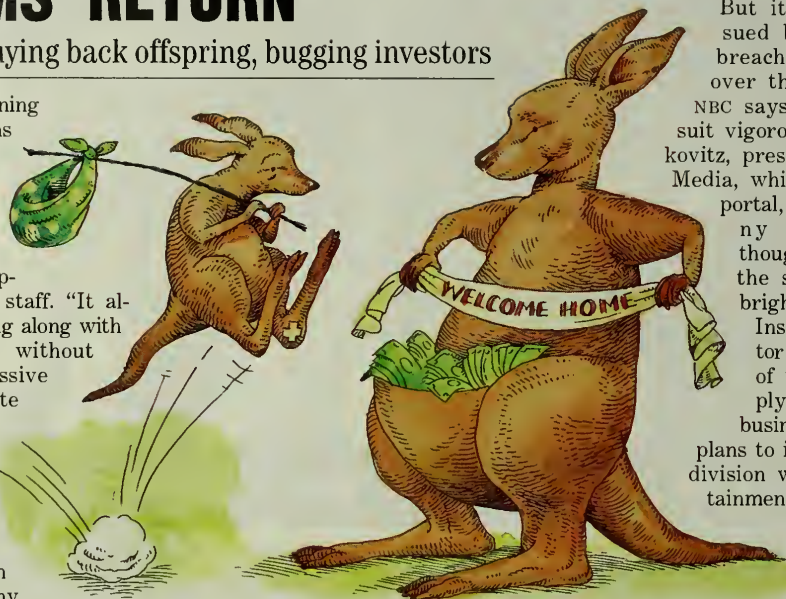
Staples Inc. faces a different problem. It’s the shareholders in parent, not

dot-com, who are upset. A class action alleges that the purchase is “a waste of Staples’ corporate assets,” according to securities filings. The buyback cost the company up to \$90 million. Staples’ dot-com was originally valued at \$3.25 a share when the tracking stock was created in November, 1999. At the time, it was given to Staples directors, venture capitalists, and some Staples employees. The goal was to take the shares public the following year, though that didn’t happen.

NBC intends to buy the shares back at about \$7, a 115% premium. A company spokesperson says the price is justified by a fivefold increase in Staples.com sales since fiscal 1999. The unit is expected to be profitable later this year.

Unhappy though they may be, shareholders in the spin-offs are better off than those who own the likes of eToys, Pets.com, and Garden.com. “There was no corporate parent to bail them out when their shares tanked,” says Michael Baum, CEO of IPO.com Inc., a financial data and software company. That’s cold comfort for shareholders nursing big losses.

By Debra Sparks in New York



The Rush to Buy Back Dot-Com Spin-Offs

COMPANY	INITIAL PRICE	REPURCHASE PRICE	DIFFERENCE
DISNEY INTERNET GROUP	\$35.44*	\$5.64	-84%
NBCI	81.38**	2.19	-97
CSFBDIRECT	20	4	-80
VITAMINSHOPPE.COM	11	1	-91
STAPLES.COM	3.25***	7	115

*At close of first day's trading **Secondary offering

***Shares issued to employees

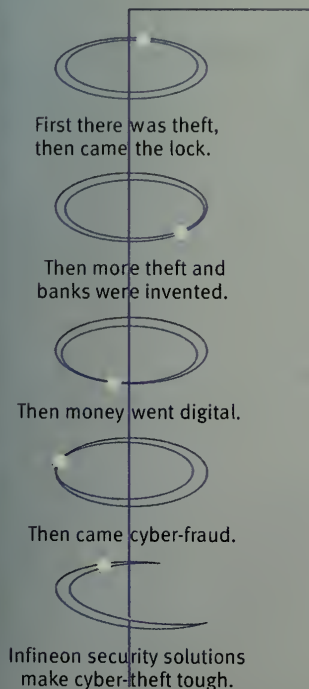
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COMMENTARY

By Marcia Vickers

NICE LITTLE RALLY YOU'VE GOT THERE, BUT...

Warren Buffett is fond of saying, "It is optimism that is the enemy of the rational buyer." Tell that to investors. Lately it seems they've been blithely jumping back into what Wall Street is calling a renewed bull market, while paying little attention to some of the market's less attractive underpinnings.

Despite a 152-point drop in the Dow Jones industrial average on May 23, there's no arguing that a pretty incredible rally has been going on. Since March 22, the Dow has soared 1716 points and approached its all-time high of 11,722. Since April 4, the Standard & Poor's 500-stock index has risen 17%, and the Nasdaq Composite Index is up 37%. What's more, small-cap and mid-cap stocks have been on a tear.

The reason for the recent runup: Investor optimism has again been unleashed. The Federal Reserve's five interest-rate cuts, although they've yet to work economic magic, have investors believing the economy is on an upward swing, and the stock market is following. Sure, it could be that the market has reignited and will soar into nosebleed territory once again. Perhaps pigs can fly, too.

ROUGH GOING. It's far more likely that the bull is just getting on its feet, coming back from 2½-year lows. But there will be more rough going before the market is ready to run. Why? There's still a weak profit picture, at least until the fourth quarter, and the economy remains relatively flat to weak. In fact, it's likely the market won't stage a sustained recovery until the fourth quarter of this year or the first quarter of 2002, when profits start to pick up, in response to the Federal Reserve's aggressive rate cuts. And forget tech stocks for now—their earnings are expected to be down at least through the year's end.

Investors are underestimating a



IT'S EARLY YET
A sustained bull run still needs a stronger economy and rosier profits

slew of economic woes. There's the energy problem, the weak euro, and a nearly \$400 billion trade deficit coupled with global economic weakness. Ger-

many and France reported gross domestic product growth of 0.4% and 0.7%, respectively, this week, well below what was anticipated. Japan's outlook is still dismal. And now that the GOP may lose control of the Senate, add political uncertainty to the mix.

Then there are earnings. Sure, some companies have been beating projections, but consider that those have been slashed to smithereens, making "coming in above expectations" about as meaningful as a buy recommendation on a dot-com stock.

Through May 18, 64% of second-quarter preannouncements have been negative. That's only slightly down from the same period last quarter. "Problems on the earnings front might cause an overly optimistic market to back off soon," says William J. Meehan, Cantor Fitzgerald's chief market analyst.

In fact, the market could retreat in coming weeks and remain in a "trading range" all summer. "We'll see some giveback and testing this summer—there will be profit problems, the Japan recession, half of California blacked out again—something will happen," says Charles Pradilla, chief investment strategist at SG Cowen Securities.

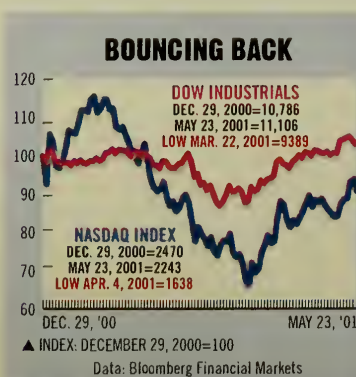
Even so, there's good news in this rally. Market breadth has improved dramatically as investors take money out of tech stocks and move it to other parts of the market: consumer services, health care, financials. That makes the chance of a bull market more likely and much more sustainable when it actually resumes.

APRIL SHOWERS. Investors have also been putting new money—much of which had been parked in money market accounts—into economically sensitive Old Economy stocks. The Morgan Stanley Cyclical Index, which consists of 30 stocks, including Alcoa Inc. and Caterpillar Inc., has outperformed the S&P by 35% over the past seven months. Even cyclical tech stocks—in semiconductor and semiconductor equipment—have been leading the recent rally.

Just because the rally may not last into summer doesn't mean we'll return to a bear market either. Most analysts say the market bottomed out in late March and early April. They're probably right. Technical indicators show that the market has finally broken through bear trend lines that have existed since September.

In order for the bull to run, however, the Fed must deliver a stronger economy and rosier profit picture. The market's not going up from here on investor optimism alone.

Vickers covers markets and investments from New York.





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www.agilesoft.com

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www.honda.com

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Applied Materials
www.appliedmaterials.com

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CANON (CCSI) & (ISG)
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COMMENTARY

By Paul Raeburn

AN AIDS BREAKTHROUGH COULD GO BEGGING

Medical researchers are on the verge of a breakthrough that could help curb the spread of AIDS and other sexually transmitted diseases. They've identified almost 60 topical ointments and gels that may prevent infections—and appear safe enough to be sold without a prescription. Called microbicides, the medications are cheap enough to be used in poor countries as well as in the U.S. and Europe. Short of a safe, affordable vaccine, microbicides “could be our best hope for preventing HIV in-

Yet most of these drugs will probably never reach the market. Many may never be thoroughly tested.

Pharmaceutical companies intent on developing the next billion-dollar blockbuster have shunned these inexpensive alternatives. There's simply no money in it for them. Drugmakers are not going to spend millions of dollars on the large-scale clinical trials—so-called Phase III studies—required by the Food & Drug Administration to produce an ointment that sells for a few dollars without a pre-

The Alliance for Microbicide Development, a consortium of biotech companies, researchers, and health advocates, says 38 biotech companies, 28 not-for-profit groups, and six public agencies are studying microbicides. Phase III studies should begin soon on some of the most promising compounds (table). But it will be at least two years before any are completed.

Most of the money for research has come from the National Institutes of Health—about \$25 million per year—and the Global Microbicide Project, established with a \$25 million grant from the Bill & Melinda Gates Foundation. That's only a start, however: The large studies needed for FDA approval cost \$8 million to \$10 million a year for each candidate drug.

Many of the studies are focusing on AIDS, but research is also showing that microbicides could be effective against other sexually transmitted illnesses. These include herpes, chlamydia—which can lead to sterility—and human papillomavirus, which can cause cervical cancer. Some of the ointments kill microbes directly, while others create a barrier to block infection or alter acidity levels to enhance the body's natural defenses.

EDUCATION IS KEY. The studies will look at the effectiveness of the drugs and their acceptability. “We don't want to develop products people aren't interested in using,” says Roberta Black, the director of microbicide research at the NIH. The drug must be applied properly at the time of sexual activity, so consumer education must be part of the development program, she says.

The medications will not reach the public, however, without more money from the government and private foundations. Health advocates have urged the NIH to triple its microbicide budget, to \$75 million per year. The Bush White House, despite its wariness of government intervention in the market, should support that hike. An AIDS vaccine could still be years away. Meanwhile, microbicides could save tens of thousands of lives.

Raeburn covers science and the environment.



MICROBICIDES NEARING LARGE-SCALE TESTING

DRUG	DEVELOPER	FUNDING	EFFECTIVE AGAINST
BUFFERGEL	ReProtect	NIH	AIDS, Papillomavirus, Chlamydia
PRO 2000	Interneuron Pharmaceuticals	NIH	AIDS, Herpes simplex, Chlamydia
CARRAGUARD	Population Council	NIH, Gates Foundation	AIDS, Herpes simplex

Data: Family Health International

NO WINDFALL

Drugmakers won't fund Phase III studies of cheap, over-the-counter ointments. And grants won't cover them—so Washington must step up

fection,” said Robin A. Weiss, a British AIDS researcher, in a recent article in the journal *Nature*.

The economics of this are clear: The U.S. spends an estimated \$8.4 billion each year to treat sexually transmitted diseases, including \$4.5 billion a year on AIDS alone, according to the Alan Guttmacher Institute, a not-for-profit research group. A few million dollars' worth of these drugs might save billions in treatment—not to mention the savings in human life and emotional anguish.

scription. “I'm not aware of a big pharmaceutical company ever searching for a new drug that they're going to introduce over-the-counter,” says Stephen W. Schondelmeyer, a pharmacist and economist at the University of Minnesota.

One drugmaker, Johnson & Johnson, is donating money and expertise to the effort as a goodwill gesture, says Barbara J. Brummer, the company's vice-president for women's health. “The best way to make it happen is to get the most knowledgeable people and pool our efforts,” she says. And the company has no expectation of making a profit from microbicides. “Our interest is in finding something to help with the AIDS epidemic,” Brummer says.

Some progress is being made outside big drugmakers' labs, however.

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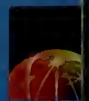
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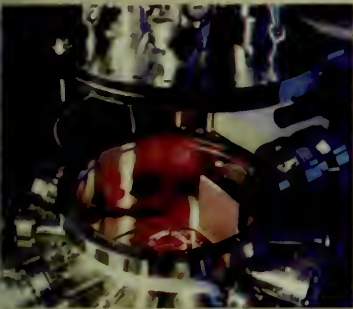
Developments to Watch

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MAKING DIESELS STINGIER THAN EVER

UCKS, BOATS, BUSES, AND GENERATORS—YOU NAME IT, diesel powers it. While diesel engines are already as much 60% more efficient than gas engines, there are tens of millions of diesels, so any small increase in fuel economy means huge savings in the big picture.

Enter the Rotating Liner Engine (RLE), a new application of an old technology that could increase overall fuel efficiency by about 5% and engine longevity tenfold. Taking a



cue from World War II-era plane engines, University of Texas (Austin) graduate student Dimitrios Dardalis found that the friction between the piston and the cylinder in which it rises and falls diminishes by about 100 times when a thin sleeve between the two is rotated at several hundred rpm. The sleeve distributes oil more evenly and keeps wear and tear from grinding down a single spot. Dardalis expects his technology to add about 20% to the cost of a diesel engine, but in an industry where lifetime fuel costs far outstrip the price of the engine, that's a good trade-off. A 500-horsepower diesel generator might cost \$17,000, but if it works 24/7, calculates Dardalis, the 6% of fuel saved by the RLE adds up to more than \$7,500 a year. And those savings rise to 27% when the engine is running. That's significant in the transportation sector, where idling truckers often leave their engines running overnight.

Patti Fong

INNOVATIONS

Alzheimer's disease has long been associated with the buildup of a brain protein called amyloid-beta. That's why many companies pursuing Alzheimer's drugs have sought to block enzymes that break down amyloid-beta, that cause the protein to accumulate. In the May 25 issue of *Science*, researchers at the Riken Research Center in Wako and Harvard University describe a different approach. They're studying an enzyme, called neprilysin, that breaks down amyloid-beta as well as a gene that controls its production in the brain. By obtaining abnormalities in that gene, doctors may someday get an early alert that certain

individuals are prone to Alzheimer's. Likewise, drugs that amplify the effects of neprilysin may one day yield a treatment.

■ For every 10 gallons of gas we pump, 1.3 oz. of vapor floats into the atmosphere, contributing to the destruction of the ozone layer. So concerned scientists at GKSS Research Center near Hamburg created a machine that sucks the vapor from the air. With each gallon of gas pumped, one and a half times as much air is pulled into the station's holding tanks, where a series of silicone-treated filters reclaim the hydrocarbons and redeposit them into the station's tanks. The air that's released is 95% clean.

Patti Fong



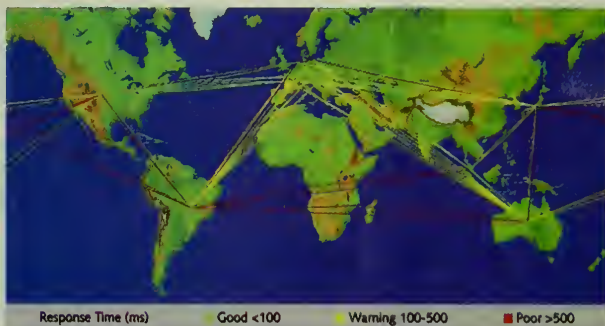
IT'S A BIRD! IT'S A PLANE! NOPE—A WINDMILL

WINDMILL FARMS TAKE UP space. They're also noisy, and can be an eyesore. So Bryan J. Roberts, a researcher at Australia's University of Western Sydney, came up with an alternative idea: a flying windmill called a gy-

romill that looks like a king-size kite stripped of fabric and outfitted with helicopter rotors. An electric motor would drive the rotors as the gyromill climbs up into the jet stream. There, the motor would be switched off. The jet stream would turn the blades, keeping the craft aloft and also generate electricity, which would be piped down to the ground via a copper-cable tether. Roberts envisions flotillas of gyromills, each producing 20 megawatts of electricity.

To prove the concept, Roberts has asked the Australian government to cough up nearly \$1 million to test a small 50-kilowatt prototype. Australia's aviation agency must approve the project, since planes would have to be banned from the area because of the dangling tethers. Roberts says a remote section of New South Wales would be ideal, and he is optimistic about getting the go-ahead later this year.

Otis Port



HOW TO AVOID TRAFFIC JAMS ON THE NET

ON-BOARD NAVIGATION SYSTEMS HELP PILOTS SPOT DEVELOPING storms. Now Mercury Interactive, a Sunnyvale (Calif.) supplier of testing software, is providing a similar service to e-businesses—except that its system tracks digital storms. The Topaz WeatherMap, a visualization program, lets companies monitor digital traffic jams as soon as they take shape. Today, businesses are at the mercy of traffic flows on Internet "backbones," and of Internet service providers that promise a certain quality of service, then blame congestion when things slows to a crawl. "Our clients who use the WeatherMap can reroute their traffic on the spot," says Mercury Chief Operating Officer Kenneth R. Klein. In effect, Mercury is issuing its own little weather alert to ISPs: high visibility ahead.

WHY CARS
GET LOWER
MILEAGE THAN
PROMISED

BusinessWeek Lifestyle

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Heh heh-heh



How To Make Fewer Trips To the Pump

With gas nearing \$2 a gallon, smart driving can save big bucks

BY DAVID WELCH

America's devil-may-care attitude about burning gasoline may finally be changing. With gasoline prices pushing \$2 a gallon in many regions, consumers are paying closer attention to the fuel-economy ratings on the window stickers of new cars. That's an about-face from the 1990s, when gas cost around \$1.20 a gallon and people nonchalantly bought millions of thirsty pickups and sport-utility vehicles.

There's one problem: Driving conditions have to be near-perfect to get the mileage that manufacturers promise. Oh, the Environmental Protection Agency works hard to get those certified ratings close to real-world driving performance. But they don't account for several factors, such

as the actual speed at which people drive, frequency of air-conditioner use, the cleanliness of gasoline at most filling stations, and the growing traffic congestion in major cities—all of which hurt fuel economy.

The test works like this: Auto manufacturers put a vehicle on a dynamometer, which simulates driving conditions while the car remains stationary. The vehicle runs at an average of 48 miles per hour to represent highway performance and 20 mph for city driving. But the test assumes optimum driving conditions, such as a passive driver who doesn't speed and the pump provides clean gasoline. The agency takes the results of auto-company tests and verifies them using dynamometers in its own laboratories. The agency then subtracts 10% from the city miles-per-gallon



rating, 22% from the highway results, and 15% from the average, to take into account road conditions that can hurt fuel efficiency.

Agency officials acknowledge that they are pleased if certified mileage is within 2 or 3 mpg of real-world performance rates. And auto makers concede that they use the EPA-approved numbers as more of a rough measure of fuel economy than a precise one. "Most people don't drive to replicate the numbers that are on the sticker," explains Mark Kemmer, a senior Washington representative for General Motors. "Our people think the EPA's numbers are relatively representative."

No one tracks how close the certified numbers get to real driving performance. But using a random sampling of vehicles, I found the EPA mileage, indeed, to be 2 to 3 mpg higher

than actual performance. Sounds small. But take the 1999 Jeep Grand

erokee owned by one of my colleagues. His, which is certified at 16 mpg, has consistently gotten 13 mpg—a 19% discrepancy. I also tested an Acura MDX sport-utility vehicle. It is certified at 19 mpg, but I got 16.7 mpg over 100 miles of driving. Meanwhile, a Dodge Durango 4x4, certified at 14 mpg, averaged 11.7 mpg when I toiled around in it.

BRID TRIUMPH. When I drove the Honda Insight and Toyota Prius—both eco-friendly cars that run on a combination of gasoline and electric power—I got great fuel economy. Still, the cars' real-world fuel-economy results on the dashboard display were about 8 mpg short of the 64 mpg the Honda boasts and 7 mpg short in the 48-mpg Prius. In fairness, a Lincoln LS sedan tested was right on the nose at 19 mpg. The reasons for the discrepancies aren't hard to fathom. Vehicles are tested as if you spend 55% of your time driving in the city and the rest on the highway. But the Sierra Club estimates that people drive in cities about 75% of the time. "The test is flawed," says Sierra Club fuel-economy guru Dan Becker, who points out that people drive at about 13 mph in cities—instantiating more fuel-guzzling, stop-and-go driving—not the 20 mph the EPA assumes. So, all those luxury gadgets and options add weight to a vehicle, reducing fuel economy, notes GM's Kemmer. Yet both auto makers and the EPA rarely test loaded cars.

On the highway, the EPA assumes a top speed of 60—which most drivers routinely

exceed unless there's heavy traffic. In fact, just 21 states still have a speed limit as low as 55 mph on urban interstates, and every state except Hawaii allows cars to travel above 55 on rural interstates. Fuel economy drops precipitously when a car is driven faster than 55 mph.

Another flawed EPA assumption: the car's average startup temperature. The EPA assumes that temperature is 65 degrees when it's really in the more gas-guzzling 50-degree range. Fuel efficiency also falls fast when you turn on the air conditioning. Yet both car companies and the EPA test cars with the AC off. Air conditioning used to be a luxury option, but today, 98% of new cars are equipped with it. "I'm afraid people are using air conditioning far more often than we think," says Jeff Alson, senior engineer at the EPA's National Vehicle & Fuel Emissions Laboratory in Ann Arbor, Mich.

Using the AC during stop-and-go city driving can cut fuel economy by 20%.

Other conditions just can't be mimicked in test labs. Wind is a big drag on fuel economy, especially on the highway, says the EPA's Alson. And while carmakers and the agency use the cleanest, best-performing fuel, water gets into gas at most filling stations, further cutting performance. If you live in a region where specially treated gasoline is mandated as a clean-air measure, that takes its toll as well.

EPA officials say they want to look into several factors that can hurt fuel economy, including how often people use the air-cooling systems in their cars. The agency also plans to study traffic congestion and how often people drive in the city vs. highways. If driving habits continue to change in ways that eat into fuel economy, the EPA could change its procedures to reflect lower real mileage, an agency official says.

What are the lessons from all of this? To meet or beat your car's fuel-economy ratings, you have to simulate the testing standards. For example, don't floor the accelerator when the traffic light turns green. Don't go much faster than 55 mph on highways. Avoid driving in congested cities. And hope for a cool summer, because if you really want good gas mileage, you'll have to do without the AC. □

Autos

Fuel Economy for Selected Cars

VEHICLE	CITY/HIGHWAY	COMBINED	ANNUAL FUEL COST*
BENTLEY AZURE	11/16mpg	12mpg	\$2,088
BMW 330CI	19/27	22	1,234
BMW X5 SUV	13/17	15	1,810
CHEVROLET SILVERADO 4X4 PICKUP	15/18	16	1,697
CHEVROLET SUBURBAN	14/16	15	1,810
DODGE CARAVAN	18/24	20	1,358
FORD ESCAPE (V6)	18/24	20	1,358
HONDA INSIGHT	61/68	64	424
PORSCHE BOXSTER	17/25	20	1,358
TOYOTA TUNDRA 4X4 PICKUP	14/17	15	1,810

*Based on driving 15,000 miles, with gas at \$1.81 per gallon
Data: Energy Dept., Environmental Protection Agency

Boosting Gas Mileage

DON'T SPEED Just going 65 mph can cut gas efficiency more than 10%. Also, using cruise control helps.

MAINTAIN YOUR TIRES Underinflated tires can increase fuel consumption by 6%.

KEEP THE ENGINE TUNED An untuned engine can cut mileage by 10% to 20%.

CHANGE THE AIR FILTER A clogged air filter can drop fuel economy by up to 10%.

SKIMP ON THE AC Air conditioning can cut mileage per gallon by as much as 20%.

Data: Energy Dept.,
Environmental
Protection Agency

Six Heads Are Better Than One

Masters' Select Equity limits each of its managers to 15 picks

BY LEWIS BRAHAM

If investing is a sport, Ken Gregory's got game. The 43-year-old president of Litman/Gregory Fund Advisors in Orinda, Calif., heads a dream team of money managers at his Masters' Select Equity Fund. After years of interviewing top managers for his newsletter, *No-Load Fund Analyst*, Gregory decided in 1997 to combine their wisdom in a single fund. The six "masters" running Masters' Select Equity include value guru Bill Miller of Legg Mason, growth expert Spiros "Sig" Segalas of Harbor Capital Appreciation, and vulture investor Mason Hawkins of Longleaf Partners.

The results have been impressive. As of May 17, Masters' Select Equity had a 10.7% three-year annualized return, vs. just 6.5% for the Standard & Poor's 500-stock index. Two other funds Gregory oversees—Masters' Select International and Masters' Select Value—have also proved champions. Select International has a 12.9% three-year annualized return, decimating the average foreign stock fund's 2.2%. Newcomer Select Value is up a healthy 18% year to date. The funds' combined assets are a healthy \$900 million.

ONLY THE CREAM. Besides strong management, the funds have another powerful weapon: concentration. Each manager can contribute no more than 15 favorite stocks to a Select fund's portfolio. By skimming the cream off their stock lists, the managers have actually performed better on a weight-adjusted basis in Masters' Select Equity and International than in the funds they run at their other companies. Although Gregory declined to disclose any comparative numbers, analysis using Morningstar software confirms this fact.



TALENT HUNT: Gregory first picked brains as a newsletter editor

Gregory is no overnight success. When he and partner Craig Litman founded their investment advisory business in March, 1987, the timing couldn't have been worse. Back then they were only selling mutual funds, not running them. Litman was a former attorney with a non-MBA degree, and Gregory had just a few years of investment consulting under his belt. So when the market crashed that October, they were ill prepared. To generate extra

revenue, they decided to start a newsletter about mutual funds with \$120,000 they borrowed from Litman's brother and a wealthy friend. They published a test issue of the *No-Load Fund Analyst* in November, 1989.

But the test readership for the first issue b

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Using multiple managers, Gregory says, if one "has a really bad year, there's just as much chance of another having a really good one"

no interest in buying a second. "When we finally launched the newsletter, our advisory business had reached a point where we knew it was going to survive," says Gregory. "We probably would have forgotten the whole thing if we didn't have to pay Craig's brother back." Instead, Gregory found himself calling several fund managers every month to profile in the newsletter. "Back then, they were surprised to get a call from anybody," Gregory says.

Doing intensive research on each fund, Gregory would choose his favorites for the newsletter's four model portfolios. The investment results were sound—the average portfolio's 10-year annualized return, 12.3%, ranks 16th out of 69 investment newsletters, according to *Hulbert Financial Digest*. Yet the newsletter has never been a rousing financial success. To date, it only has about 1,500 subscribers. But it has provided Gregory with access to some of the best minds on Wall Street.

That access taught him some valuable lessons. "From our conversations with managers, we

Hawkins' cheap oil stocks were a drag. Last year, they switched places. Hawkins' 1999 favorite, Pioneer Natural Resources, rose 120% while Cisco fell 29%.

Finding the best manager is Gregory's real challenge. He looks for outperformance year after year, not just a one-time blip. He also looks for low management fees: Masters' funds all charge less than 1.5%. He prefers small fund shops with few assets to behemoths like Fidelity and Putnam Investments. He wants a disciplined investment style that's consistent and readily discernible. "I don't like intuitive managers," Gregory says.

He carefully crafted the portfolio allocation at Masters' Select Equity to cover all the bases: large and small stocks, growth, and value. His job is to make sure everybody sticks to their guns. When his value managers suddenly start buying price biotech stocks, it throws everything off balance. To keep tabs, he meets with managers and their analyst teams as often as possible. "That's essential when running concentrated portfolios," says Bill Nygren, who runs 25% of Masters' Select Value. "If you're letting a manager's stock picks have a major impact, it's crucial to know exactly how they invest."

Gregory's newsletter and fund strategies differ. In the funds, the manager allocations are fixed: 20% Bill Miller in Select Equity; 20% Janus' Helen Young Hayes in International. But in the newsletter, often shifts from one manager to another depending on market conditions. Recently, he has been adding junk-bond and real estate funds to his portfolios because he likes their valuations. He can't do that at Masters' Select Equity with its contractual relationship with each manager.

Gregory rarely fires a manager but sometimes the fit isn't right. In 1998, he replaced Jean-Marie Eveillard at Masters' Select Equity with Oakmark Fund's value guy, Robert Sanborn. Eveillard, the well-regarded manager of the First Eagle Science Gen Overseas Fund, didn't like Masters' concentrated style, holding

more than 125 stocks in his own fund. "Eveillard was a mismatch of style," says Josh Weiss, Litman/Gregory's research director. "He's more accustomed to being a diversified manager." Nygren did Sanborn work out. Poor performance drove Gregory to replace him with Bill Miller last year.

Lately, Gregory has been doing more hiring than firing. Running the Masters' funds keeps him working 65 to 70 hours a week. Litman/Gregory, meanwhile, is busy managing the firm's private equity accounts. To ease their burden, they recently hired two fund analysts to edit the newsletter. Despite the demands on his time, Gregory still enjoys talking to a fund manager a week. "I learn a lot from these guys," he says. What could be better than learning from a master?

Masters of Their Universe

FUND/ SYMBOL	MANAGERS	% OF PORTFOLIO	OTHER FUNDS
MASTERS' SELECT EQUITY/ MSEFX	Christopher Davis	20%	Selected American
	Foster Friess	10	Brandywine Fund
	Mason Hawkins	20	Longleaf Partners
	Bill Miller	20	Legg Mason Value
	Sig Segalas	20	Harbor Capital Appreciation
	Richard Weiss	10	Strong Advisor Common Stock
MASTERS' SELECT INTERNATIONAL/ MSILX	Helen Young Hayes	20%	Janus Overseas
	David Herro	20	Oakmark International
	Daniel Jaworski	20	Marshall International Stock
	Ted Tyson	20	American Century International Growth
	Mark Yockey	20	Artisan International
MASTERS' SELECT VALUE/ MSVFX	Mason Hawkins	25%	Longleaf Partners
	Bill Miller	25	Legg Mason Value
	Bill Nygren	25	Oakmark Select
	Larry Sondike	25	Mutual Shares

Data: Litman/Gregory Fund Advisors, Morningstar Inc.

came to believe that their conviction level about the stocks they owned was not equal," Gregory says. "If they owned 50 or 100 stocks, there might be only 5 or 10 they felt very confident about." He learned one other painful truth: Even the best managers are often wrong.

COVERING ALL BASES. Those insights gave him the foundation for his multimanager approach. "By having multiple managers, if one manager has a really bad year, there's just as much chance of another having a really good one," Gregory says. At Masters' Select Equity, different managers have carried the team at different times. When growth stocks were in favor in 1998 and 1999, Sig Segalas' technology picks, such as Cisco Systems, provided the most lift, while Mason

AT MANY COMPANIES, SOME OF THE HARDEST WORKERS HAVE THE BEST PARKING SPACES.

15 million Americans have disabilities. Two-thirds of those of working age do not have jobs. It is a mistake to ignore these talented individuals who prove their capacity to overcome challenges each and every day.

Our goal is for people with disabilities to fully participate in all aspects of life—including the workplace. The following members of our CEO Council help us fulfill this mission. They realize that hiring people with disabilities is not just a good thing to do, it's good business.

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WHAT IF SUDDENLY YOU CAN'T WORK?



BY TODDI GUTNER

hers@businessweek.com

The worst time to discover that you need extra disability insurance is—when you need it. Do the math now to ensure you have adequate coverage

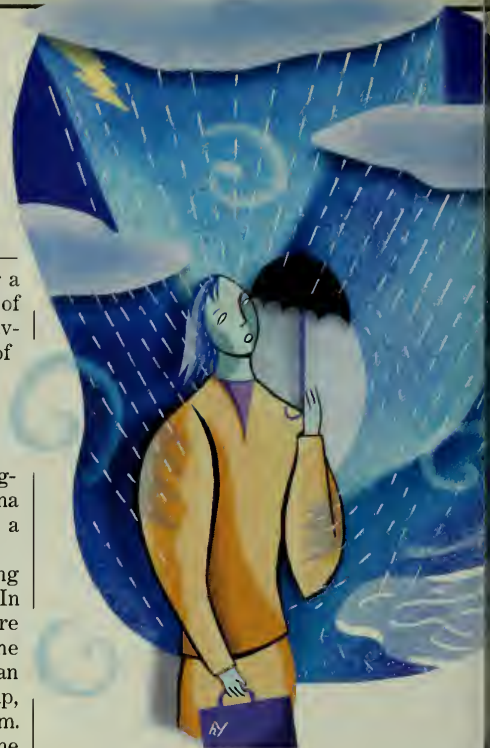
If you think you've saved enough to weather a long-term disability, consider this: A year of total disability can wipe out 10 years of savings for someone who has socked away 10% of income annually, according to Northwestern Mutual insurance company. Yet few wage earners are sufficiently covered by disability insurance. That's troublesome, since "a person in their 40s is more likely to have a long-term disability than they are to die," says Anna Rappaport, a principal with William M. Mercer, a human-resources consulting firm.

Evidence suggests that women are putting themselves at greater financial risk than men. "In many couples, where the husband earns more than the wife, there is a rationalization that the wife doesn't need disability insurance," says Dan Moisand, president of Optimum Financial Group, a Melbourne Beach (Fla.) financial-planning firm. But the reality is women with jobs outside the home are three times more likely to miss work because of a disability, including maternity leave, than men, says a 1999 survey by the Labor Dept. And they often can't count on the husband's salary to make up the lost income.

Women without disability coverage are not the only ones in peril. Even if the company offers a standard disability benefit, it usually isn't enough. Most people need to buy a supplemental policy—either through their employer, if one is available, or privately—to make sure 60% to 70% of their total taxable income is protected. (Be aware that you can't replace 100% of your salary because the insurer wants to make sure you have an incentive to return to work.)

STILL TAXED. Employer-provided coverage falls short for several reasons. While such plans often say they protect up to 60% of base salary, when the company pays the premiums, the employee will owe income tax on the benefits. That reduces the percentage of income replaced. What's more, many group policies have a monthly payment cap of \$5,000 to \$10,000, which can cut into benefits for higher earners. And most plans don't cover income from bonuses. But many workers aren't aware of all this. Among those employees who had employer-provided disability coverage, 43% of them didn't know what their benefit provided, according to an April, 2000, study by the Consumer Federation and the American Council of Life Insurers.

A supplemental insurance policy can help to



make up the shortfall. My own situation is case in point. Using the Disability Income calculator at www.northwesternmutual.com found that my employer's basic plan covers 48% of my current take-home pay. (Social Security

has a disability component, eligibility requirements are strict.) **ADEQUATE CUSHION.** Fortunately, The McGraw-Hill Companies, which owns *BusinessWeek*, offers a low-cost, long-term disability option which runs me \$21 a month or \$252 a year. A private policy with similar coverage would cost at least \$1,700 a year or about \$144 a month. My employer's coverage is not subject to income taxes because I pay the premiums with aftertax dollars. The policy pays benefits for up to 24 months, provided my disability prevents me from performing my job. After two years, I am eligible for benefits only if my disability prevents me from doing anything I qualified to do. All told, it protects an additional 25% of my salary for a total replacement benefit of 75%, which gives me a comfortable cushion should I become disabled.

Disability insurance can be complicated. But you're better off taking the time now to make sure you're properly covered than to wish you had done so when it's too late.

Buyer's Guide

Make sure your disability insurance policy...

- Provides benefits up to retirement age
- Has a waiting period of no more than 90 days before coverage kicks in
- Gives a guaranteed right to renew annually
- Offers broad protection against a comprehensive range of risks
- Provides benefits for partial disability
- Comes from a company with a strong credit rating

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WHY REFINERS DESERVE A LONG SECOND LOOK



BY ROBERT BARKER

rb@businessweek.com

Wall Street's estimates seem too gloomy, considering how far demand is outstripping supply for gasoline

Spending \$23 to fill up a station wagon, as I did the other day, is no one's idea of a good time. Unless you're an oil refiner. Companies that do the dirty work of turning crude into fuel are enjoying their best days in many years. Profits are surging. So are the stocks. Some, such as Holly and Frontier, are up better than 85% this year. Ultramar Diamond Shamrock, which is set to merge with Valero Energy, has more than doubled in the past year.

So this must be the time to sell these stocks, right? Oil refiners' profit margins may soon top out, yet few in the industry see margins plunging to old lows. That bullish scenario—margins dropping back a bit, yet still remaining high—is hardly being credited on Wall Street. In a twist on the custom of companies tamping down Wall Street's earnings estimates, some refiners say analysts' forecasts are just too pessimistic.

Take Tesoro Petroleum. The Street expects the San Antonio company to earn \$1.95 a share this year. Tesoro already earned 52¢ a share in the seasonally slow first quarter. It sees profit for the year of at least \$2.40. In 2002, the Street thinks Tesoro will suffer a slide in earnings, to \$1.41. Tesoro is eyeing \$3. For Houston-based Frontier Oil, the analysts' consensus forecast of 2001 profit is \$1.96 a share. "We will substantially beat that," Frontier CEO Jim Biggs told me. "The estimates are going to end up being way low."

Not every refiner is so openly bullish. Sunoco, which after the Valero-Ultramar merger will be the No.2 independent, thinks the inherent volatility of commodity prices turns profit forecasts into so much guesswork. Yet not even Sunoco envisions refining margins swinging back down to

1999 levels. In the first quarter that year, Sunoco's main refining operation grossed just \$2.04 per barrel. This year, the first quarter brought a margin of \$7.80 per barrel, profitability that is persisting so far this spring.

The good times for refiners are flowing directly from one fact: As with

electricity in California, the U.S. uses more gasoline than it can make. The nation's refineries have been running flat out, and although imports are climbing, inventories remain low. That's why the average price for a gallon of regular in early May topped \$1.70, up from \$1.46 a year ago. Since no one is planning to build refineries, 1976 saw the last brand-new one—there's little slack in the production chain. It figures to be tightened further by new environmental rules that render some older refineries obsolete.

BIG DEALS. Some veteran investors, such as Vanguard Energy Fund's Ernst von Metzsch, think that if inventories build for the summer driving season and prices ease a bit, stocks of refiners may sell off their highs. Yet that would be a good opportunity to von Metzsch, who already owns Ashland, Sunoco, and USX-Marathon, each with major refining stakes. They all look cheap to him given the high asset values implied by Phillips Petroleum's \$7 billion bid for Tosco and Valero's \$6 billion Ultramar merger.

If Valero completes its deal, it will run neck-and-neck with Exxon Mobil as the leading U.S. oil refiner, including 488,000 barrels a day in California. CEO Bill Greehey says Wall Street is out to lunch on the profit potential. "The analysts really are not keeping up with what's happening," he said. The Street sees Valero, assuming the deal goes through, earning \$7.08 a share in 2001. Greehey told me Valero will earn at least \$7. And he expects the companies this year to put out \$1 billion in "free" cash flow—that is, \$1 billion after another \$1 billion in capital spending.

Does this mean oil-refining stocks have nowhere to go but up? No, but look at it from this angle: Many people, myself included, would be sorry if Internet auctioneer eBay disappeared tomorrow. But if Valero's California refinery went poof, a persistent wailing would be heard from Left Coast to Right. The market value of eBay at \$17 billion. Valero and Ultramar's market values add up to \$7 billion. Next time you pump gas, see if you don't think that's out of whack.

Oil Refiners: Low Expectations

COMPANY/ SYMBOL	PRICE 5/21/01	2001 EPS*	2002 EPS*	BARRELS PER DAY, THOUSANDS
FRONTIER OIL FTO	12.80	1.96	1.08	151
GIANT INDUSTRIES GI	10.35	NA	NA	37
HOLLY HOC**	38.50	5.40	4.80	67
SUNOCO SUN	42.10	4.65	4.18	730
TESORO PETROLEUM TSO	15.40	1.95	1.41	275
VALERO-ULTRAMAR VLO***	51.85	7.62	7.08	1,865

*Estimates **Fiscal years ending July ***Pro forma, assuming completed merger
NA=Not available Data: Company reports, First Call, and Zacks estimates

BusinessWeek online

For a Q&A with Vanguard's von Metzsch, go to barker.online at www.businessweek.com/investor/ and click on "Columns."

**i-mode is taking
the business world by storm.**

The i-mode business solution

i-mode has literally transformed the Japanese cellular landscape, creating a burgeoning new market for mobile multimedia services. Particularly in the business world, i-mode based solutions are having a significant impact on day-to-day operations.

Distribution industry

One of Japan's leading companies in the field of integrated distribution services has turned to e-mode in its efforts to improve customer relations.

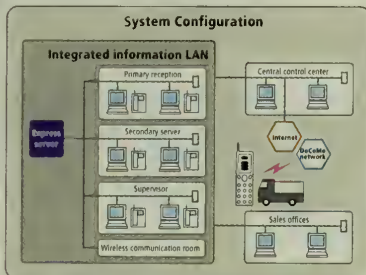
Previously, the company employed vehicle-based communication systems that were expensive to replace, limited to voice transmission, and ineffective when drivers left the vehicles. These factors often contributed to unacceptable delays in responding to customer requests.

i-mode captured the company's attention because of its small initial investment, superior mobility, and ability to transmit both images and text. Once integrated into the company's information system, it allowed customer centers to communicate directly with drivers — even when away from their vehicles. Moreover, precise customer details and collection-and-delivery instructions could be relayed and shared with utmost reliability via visual data.

A resounding success, the system has given the company an edge over the competition in delivery efficiency and customer satisfaction. It

has also sped the development of additional sales functions for the company's truck drivers.

Anticipating still further improvements in the quality of its services, the company is now adding new i-mode based services for package inquiries, delivery completion e-mail, and delivery receipt certificate requests.



Sales industry

A major sportswear company in Japan that operates over 300 outlets throughout the archipelago is another example of a business that has benefited from i-mode.

In the past, the company's salespeople submitted sales reports and customer feedback via fax, requiring secretaries at the head office to type the information into a company database. It was a time-consuming process prone to errors and delays.

Since April of last year, however, over 600 of its sales coordinators have been equipped with compact i-mode phone terminals from which up-

to-the-minute information is directly transmitted to a company Web site.

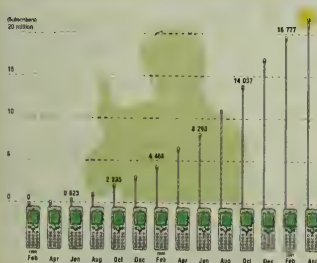
Available to all personnel nationwide, whether in the field or the office, the company site helps keep everyone equally informed and enables more knowledgeable decisions ASAP. According to a company spokesman, the potent combination of i-mode and the company Web site is painting a more accurate picture of market conditions and contributing to the company's development of a more effective branding strategy.



i-mode in Japan

NTT DoCoMo's i-mode cellular service has attracted over 22 million subscribers since its introduction in Japan in February 1999, accounting for over 60% of the company's total 36 million subscribers.

With the press of a button, users can access over



i-mode's meteoric rise continues unabated. By the 8th of April, the service had attracted over 22 million Japanese subscribers.

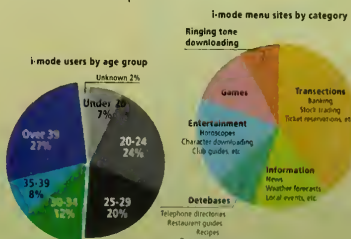
1,600 i-mode menu sites and 40,000 voluntary sites and use specialized services that range from e-mail, online shopping, ticket reservations and databases to news, entertainment and transactions with numerous Japanese banks.

i-mode content is based on a subset of HTML, the world's de facto scripting language. This makes conversion from Internet content a remarkably simple process for content providers.

DoCoMo also caters to user demands with reasonable fees. Through the advanced packet transmission system of NTT DoCoMo, users are charged for volume of data received, rather than time spent online. This promotes longer, more frequent visits. In fact, over 90% of i-mode subscribers are active users, accessing an average of 11 sites per day.

The clarity of DoCoMo's vision has been critical to i-mode's success. When the service was launched in 1999, many believed there was little room for growth in Japan's nearly saturated mobile phone market. But DoCoMo's confidence that data traffic would open up new business avenues was clearly justified.

Thanks to NTT DoCoMo's technological leadership and win-win relationships with content providers and phone vendors, i-mode keeps evolving by leaps and bounds. New **Java** capabilities, for example, allow users to download applets, receive automatic updates on weather, stock prices, company appointments and more. When the high-speed multimedia power of **3G arrives** — through **FOMA**, the world's first third-generation mobile service — there will be no end to i-mode's business possibilities.



i-mode is the name used in Japan for NTT DoCoMo's mobile internet service. **FOMA** (Freedom Of Mobile multimedia Access) is the name used in Japan for NTT DoCoMo W-CDMA services.

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SCIOS IS TAKING HEART



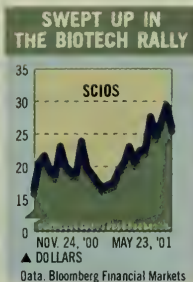
MARA HOVANESIAN

ew cardiac
g may soon be
pping up Scios.
st has cleaned
with its B2B
work products.
Dassault could
looking closely
MSC Software

Biotechs are back: The Amex Biotech Index has soared 20% since Apr. 1, after floundering for much of the year. Small-cap Scios (SCIO) has been swept upward, too. And with good reason: The company is about to introduce one of the first new drugs in a decade for acute congestive heart failure, says Rachel Leheny of Lehman Brothers. Even though the disease afflicts 5 million Americans a year, current treatments are "suboptimal," she says. Leheny views Scios' Natrecor as a blockbuster. The Sunnyvale (Calif.) company looks to Natrecor to pump up revenues by a modest \$14 million this year and by \$72 million in 2002.

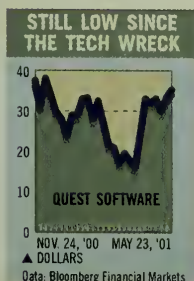
The Food & Drug Administration's initial rejection of Natrecor in April, 1999, had been depressing the stock. Scios traded at a 52-week-low of about \$3 in May, 2000, but climbed to \$30.50 last month, before sliding to \$26. Leheny tags Scios a "strong buy," with a \$38, 12-month target. In April, another analyst, Needham's Dr. Mark Monane, raised his yearend target to \$37.

An FDA committee will review Natrecor on May 25 and give it a nod or a nix by mid-July. The company and analysts are optimistic. Meanwhile, Scios will lose money as it beefs up for the hoped-for rollout. The net loss was \$1.15 a share last year, and Leheny expects a \$1.39 loss in 2001—vs. First Call's consensus of a \$1.47 loss. Monane projects Scios will earn 50¢ a share by December, 2003, and \$1.90 by 2004, when he estimates sales of Natrecor will reach \$219 million. Scios is not a one-trick pony, however: Analysts say trials of SCIO-469, a treatment for rheumatoid arthritis, look promising. Research pacts with Chiron and Eli Lilly will help fill the pipeline.



QUEST'S GUNG HO QUEST FOR GROWTH

Although corporate info-tech spending has fallen off a cliff, Quest Software (QSFT) is hanging tough. Its products help companies monitor B2B networks. Quest announced record results for the first quarter ended Mar. 31: revenues of \$63 million, up 120% from a year ago and up 13% from the prior quarter. Earnings of 6¢ a share surprised Wall Street and catapulted the stock, trading at a 52-week low of \$14.60 on Apr. 4, to its current \$35—admittedly a far cry from the \$97.50 it hit before the tech wreck. Quest still commands a pretty premium, but Ed Bierdeman of Moors & Cabot



Tech Research Group says Quest deserves special valuation: "It's young, and it's growing 100%-plus in revenues," he says. Bierdeman has raised his earnings estimates to 30¢ a share this year and 47¢ in 2002. His 12-month price target: \$60.

Quest's revenues stem from license sales and maintenance fees. And, adds Morgan Stanley Dean Witter's Joseph Farley, its product line is "crowding out the competition"—namely Netiq and Precise Software Solutions. Since its 1999 initial public offering, Quest has gobbled up firms to grow. Still owned 69% by insiders, it has other things going for it, says Farley: a strong balance sheet and widening operating margins.

MSC: A BIG BOOST FROM A BUYOUT

For a virtual test drive of their products, General Motors, Lockheed Martin, and NASA look to MSC Software (MNS). MSC's simulation software lets companies digitally stress-test designs for products such as cars and rockets before manufacturing begins. Now, MSC has created versions of its software to make it accessible to companies that have smaller, more mundane products—and that want to get to market faster. It has signed up Cooper Tire, Medtronic, and Cleveland Golf, which is using the simulation software to test new clubs. MSC is "expanding by taking a product loved by engineers to the mainstream," says Daniel Bandi, co-manager of the \$580 million Armada Small-Cap Value Fund. Bandi holds a 2% stake in MSC. On May 22, MSC hit a 52-week high of \$18.85. Bandi's yearend target is \$30.

Other forces could push the stock higher, says Bandi, such as perhaps joining the Russell 2000 on June 30. The company may also be buyout bait, says Bandi. In May, France's Dassault Systèmes traded its 19% stake in an IT group, Advanced Enterprise Solutions (AES), for 9% of MSC. (MSC had acquired AES on Apr. 24.) Bandi says a Dassault takeover has been rumored for "several years," but the stakes are higher now. Merrill Lynch's Jay Vleeschhouwer is bullish on the stock, but skeptical about the takeover. For 2001, he sees revenues of \$201.7 million, up 13%, and earnings of \$1 a share, up 36%. He adds, though, that if buying AES boosts MSC's profits as much as it has suggested, "the current price could turn out to be conservative."

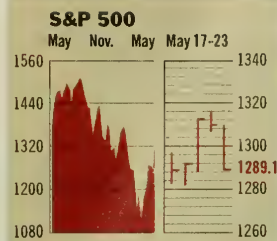


Gene Marcial is on vacation.

BusinessWeek online

Read Gene Marcial's Inside Wall Street Online column Tuesday afternoons at www.businessweek.com/today.htm. And see him Fridays at 1:20 p.m. EST on CNNfn's *The Money Gang*.

Stocks



COMMENTARY

Every streak must end. The Nasdaq, on a six-day tear, finally struck out on May 23, falling 3% that day. For the week, however, the index was still up 3.6%. The broader market took a breather: The S&P 500 was flat, while the Dow Jones Industrials fell 1%. The real surprise, though, is the continued strength of the MidCap 400 and SmallCap 600, up 1.6% and 2.2%, respectively.

Data: Bloomberg Financial Markets
Bridge Information Systems, Inc.

U.S. MARKETS

	May 23	Week	Year to date	Last 12 months
S&P 500	1289.1	0.3	-2.4	-6.2
Dow Jones Industrials	11,105.5	-1.0	3.0	6.6
Nasdaq Composite	2243.5	3.6	-9.2	-29.1
S&P MidCap 400	532.9	1.6	3.1	17.0
S&P SmallCap 600	231.5	2.2	5.4	19.9
Wilshire 5000	11,922.6	0.8	-2.1	-5.5

SECTORS

	May 23	Week	Year to date	Last 12 months
BusinessWeek 50*	908.7	0.2	-6.3	-18.0
BusinessWeek Info Tech 100**	522.0	3.5	-7.7	-35.7
S&P/BARRA Growth	641.9	0.4	-6.6	-19.4
S&P/BARRA Value	647.2	0.2	1.7	8.2
S&P Energy	953.9	-1.3	2.4	5.4
S&P Financials	161.1	0.8	-2.2	18.0
S&P REIT	89.9	2.2	2.2	13.2
S&P Transportation	746.7	-0.3	7.0	27.4
S&P Utilities	339.8	2.5	-3.1	26.9
GSTI Internet	149.5	5.5	-17.7	-62.4
PSE Technology	795.3	2.5	-2.4	-13.3

*Mar. 19, 1999=1000

**Feb. 7, 2000=1000

BEST-PERFORMING GROUPS

	Last month %	Last 12 months %
Engineering & Constr.	32.9	136.5
Gold Mining	21.4	80.7
Specialty Appr. Retailers	19.7	76.6
Office Equip. & Supplies	16.5	76.5
Insurance Brokers	15.1	57.1

GLOBAL MARKETS

	May 23	Week	Year to date
S&P Euro Plus (U.S. Dollar)	1234.6	-1.1	-
London (FT-SE 100)	5897.4	0.2	-
Paris (CAC 40)	5630.7	2.0	-
Frankfurt (DAX)	6215.3	1.1	-
Tokyo (NIKKEI 225)	14,067.7	2.7	-
Hong Kong (Hang Seng)	13,839.1	3.8	-
Toronto (TSE 300)	8348.6	3.8	-
Mexico City (IPC)	6782.5	12.4	-

FUNDAMENTALS

	May 22	Wk. ago
S&P 500 Dividend Yield	1.20%	1.26
S&P 500 P/E Ratio (Trailing 12 mos.)	29.6	28.1
S&P 500 P/E Ratio (Next 12 mos.)*	23.0	21.9
First Call Earnings Revision*	-2.25%	-3.72

*First Call Corp.

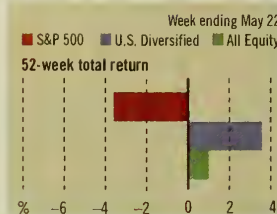
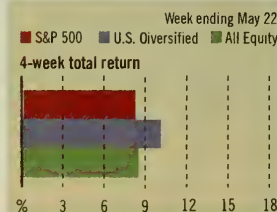
TECHNICAL INDICATORS

	May 22	Wk. ago
S&P 500 200-day average	1334.4	1338.0
Stocks above 200-day average	74.0%	68.0
Options: Put/call ratio	0.55	0.67
Insiders: Vickers Sell/buy ratio	2.64	2.51

WORST-PERFORMING GROUPS

	Last month %	Last 12 months %
HMOs	-9.7	Communications Eq.
Automobiles	-9.7	Metal & Glass Cont.
Transportation Services	-3.8	Long-Dist. Telecom
Natural Gas	-3.6	Semiconductors
Drug Chains	-2.5	Instrumentation

Mutual Funds



Data: Standard & Poor's

EQUITY FUND CATEGORIES

4-week total return	%	52-week total return	%
Leaders		Leaders	
Precious Metals	17.8	Financial	32.7
Small-cap Growth	15.0	Small-cap Value	29.8
Technology	14.8	Mid-cap Value	26.3
Health	14.7	Natural Resources	23.4
Laggards		Laggards	
International Hybrid	2.4	Communications	-29.5
Europe	2.8	Technology	-29.0
Utilities	2.9	Japan	-24.5
Foreign	3.3	Diversified Pacific/Asia	-20.4

EQUITY FUNDS

4-week total return	%	52-week total return	%
Leaders		Leaders	
World GenomicsFund com	39.7	Schroder Ultra	103.3
Profunds UltraOTC Inv.	31.6	CGM Focus	76.3
Potomac Internet Plus	31.0	Burnham Financial Svcs. A	75.6
ING Internet A	30.4	Bost. Part. Sm. Cap Val. II	74.0
Laggards		Laggards	
Profunds UltraShort OTC	-28.8	Profunds UltraOTC Inv.	-71.2
Rydex Dynamic Vent. 100	-28.5	Jacob Internet	-68.1
Potomac Internet Short	-22.4	Firsthand Communications	-60.9
Potomac OTC Short	-16.2	Firsthand E Commerce	-60.4

Interest Rates

KEY RATES

	May 23	Week ago
MONEY MARKET FUNDS	4.28%	4.41%
90-DAY TREASURY BILLS	3.64	3.57
1-YEAR TREASURY BILLS	3.69	3.72
10-YEAR TREASURY NOTES	5.40	5.48
30-YEAR TREASURY BONDS	5.79	5.86
30-YEAR FIXED MORTGAGE†	7.20	7.21

†BancQuote, Inc.

BLOOMBERG MUNI YIELD EQUIVALENTS

Taxable equivalent yields on AAA-rated, tax-exempt bonds, assuming a 31% federal tax rate.

	10-yr. bond
GENERAL OBLIGATIONS	4.47%
TAXABLE EQUIVALENT	6.48
INSURED REVENUE BONDS	4.58
TAXABLE EQUIVALENT	6.64

THE WEEK AHEAD

PERSONAL INCOME Tuesday, May 29, 8:30 a.m. EDT ► Personal income in April likely rose 0.3%, after a 0.5% gain in March. That's the median forecast of economists polled by Standard & Poor's MMS, a unit of The McGraw-Hill Companies. Consumer spending likely grew by 0.4% in April on top of a 0.6% jump in March.

CONSUMER CONFIDENCE Tuesday, May 29, 10 a.m. EDT ► The Conference Board's index of consumer confidence likely rose to 111.3 in May, from 109.2 in April.

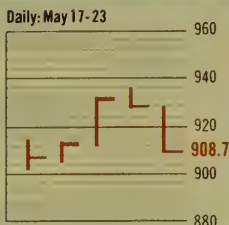
EMPLOYMENT Friday, June 1, 8:30 a.m. EDT ► Nonfarm payrolls probably lost 23,000 jobs in May, after a decline of 223,000 jobs in April. The drop will likely push the unemployment rate to 4.6%, from 4.5% in April. According to the S&P MMS median forecast, hourly earnings probably rose 0.3% in May, after advancing 0.4% in April.

PURCHASING MANAGERS' INDEX Friday, June 1, 10 a.m. EDT ► The National Association of Purchasing Management's index

of May industrial activity likely rose for fourth straight month, to 44%, from 43.2% in April. Even so, the index shows that manufacturing is in re-

CONSTRUCTION SPENDING Friday, June 1, 10 a.m. EDT ► Building outlays in April forecasted to rise 0.5%, after a surprisingly strong 1.3% increase in May. Lower interest rates, caused by the Federal Reserve's aggressive easing monetary policy, have especially helped residential construction.

BusinessWeek Fifty

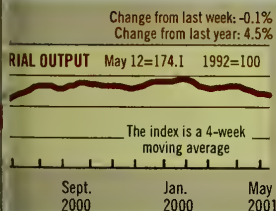


As the index changes, the more they remain the same. The BW 50 wound up in positive terrain, but just barely. The biggest movers included global power company AES, which surged 13.6% and Sun Microsystems, whose stock gained on positive analyst reports. The hardest hit stock was EMC, down 8.3%. EMC hinted at cost-cutting measures, including layoffs. Energy companies across the board also posted losses.

COMPANY PERFORMANCE

Company	% change		Rank	Company	% change	
	Week	Since 3/1/01			Week	Since 3/1/01
International	4.1	6.2	26	Verizon Communications	-2.2	10.9
Petroleum	-1.7	2.4	27	Alza	-2.2	23.5
	0.7	19.4	28	Citigroup	0.4	6.9
	1.2	17.0	29	Sun Microsystems	15.1	7.1
Materials	-2.1	16.8	30	Merck	-5.2	-7.2
Financial	5.4	18.4	31	El Paso	5.0	-8.5
Petroleum	-1.4	26.0	32	Altera	2.0	8.7
	-0.6	2.5	33	Marsh & McLennan	4.1	3.6
Tele	0.2	9.3	34	Household International	-3.1	13.8
	2.6	-21.3	35	Chevron	-1.1	8.5
Brothers Holdings	0.3	16.0	36	SBC Communications	-4.6	-5.8
	-8.3	-11.0	37	Mercury Interactive	2.3	16.5
	13.6	-12.8	38	ADL Time Warner	4.2	25.6
Laboratories	8.0	3.6	39	Washington Mutual	0.1	8.5
Financial	2.4	1.7	40	General Dynamics	0.0	19.2
Technology	2.7	12.1	41	Comcast	-3.8	-3.9
	2.9	9.5	42	Morgan Stanley Dean Witter	3.5	12.4
Hess	-2.3	18.5	43	Tellabs	5.0	-6.8
Energy	1.0	12.7	44	Exxon Mobil	0.0	10.0
Communications	4.9	-12.1	45	Scientific-Atlanta	5.4	36.0
Financial	4.4	24.6	46	U.S. Bancorp	1.8	-4.0
Petroleum	3.4	24.0	47	Paychex	2.2	0.8
Devices	5.7	21.0	48	Merrill Lynch	-2.4	13.8
Services	-1.1	7.2	49	Bed Bath & Beyond	3.0	19.5
Health	-2.5	2.3	50	Texas Instruments	2.8	22.2

Production Index



The index fell for the sixth straight week. Because of the four-week moving average, the index fell 3.1, from 174.4. After seasonal adjustments, truck assemblies were lower as plant production is expected to fall for the fourth in the second quarter. Steel, crude-oil and electricity were also lower for the week. Shipments, with rail-freight traffic and lumber, were higher.

Each of the index components is at www.businessweek.com.
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BW 50 Track the index and the companies in it all day long. Plus: our exclusive Info Tech 100 index.

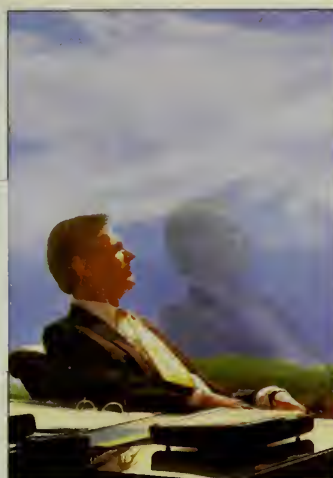
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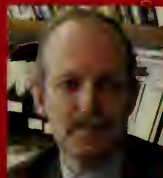
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Antti Viitanen
Vice President, Sonera



Chris Voss
Foundation Chair in Management, Technology, and Learning, and Deputy Dean, Programmes, London Business School

Additional Speaker

Gil McWilliam
Associate Professor of Marketing, London Business School

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**WHAT HE JUST LEARNED
WILL ALLOW HIM TO ENJOY
MANY OF HIS GRANDKIDS'
BIRTHDAYS TO COME.**

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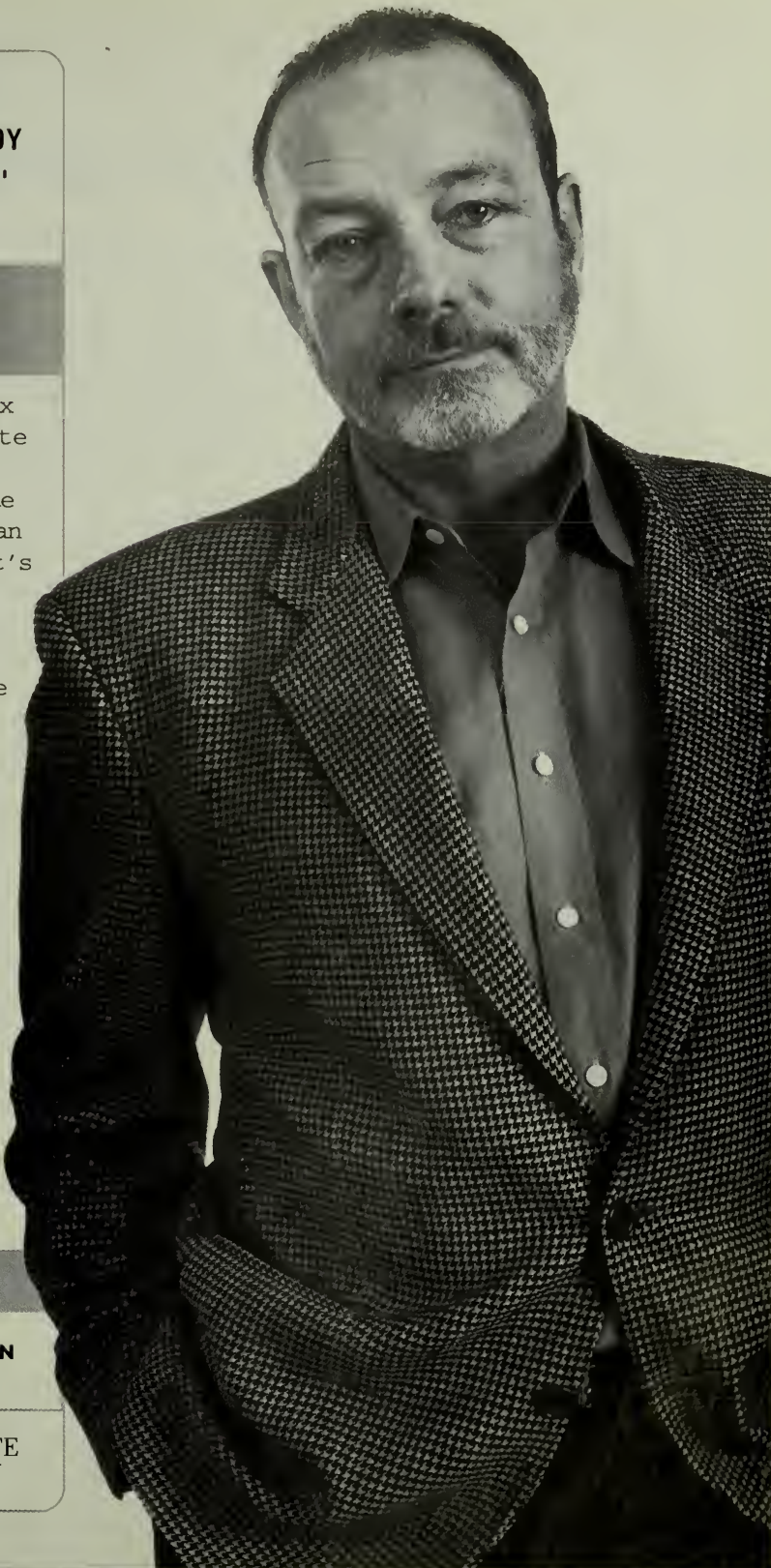
The Prostate Cancer Initiative—a nationwide collaboration to serve clinical research, patient care and public education needs.

To learn more about prostate cancer and the importance of getting regular checkups, write the Cancer Research Institute at 681 5th Avenue, NY, NY 10022 or call the American Cancer Society at 1-800-ACS-2345, or access www.4npcc.org.

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THE TAX CUT: NOT MUCH ECONOMIC PAYOFF

George W. Bush's tax cut will be a major political victory, but how much it will bring in the way of economic benefit remains unclear. A year ago, a cut of this magnitude was generally dismissed as a Republican pipe dream. Not only will the President get practically all of the tax reduction he has sought, he will get it out of Congress in record time—faster than Ronald Reagan did in 1981. But to pay for such a mammoth tax cut, Bush had to stretch the plan so far into the future that much of the tax relief is delayed for years. Five new Congresses and one or two more Presidents will have to subscribe to the tax package over 11 years for it to deliver its full benefits. That's highly unlikely. President Reagan's tax cuts came in three years, within his first term. It would have made more economic sense if Washington had passed a simpler, more front-loaded tax cut (page 34).

Do the math: Americans will see barely 20% of the \$1.35 trillion Senate tax cut by the time President Bush runs for reelection in 2004. The most important part of the tax package—the cut in marginal income rates—comes in dribs and drabs, with one percentage point sliced in 2002, another three years later in 2005, and yet another two years after that. Dropping marginal rates is a key to stimulating growth, and this delay attenuates its possible effect on the economy. It also slows the relief given to those in the top brackets, who pay most of the income taxes and often face combined federal and state taxes approaching 50%. The good news is that taxpayers at the bottom end get immediate tax relief. The only tax benefits that start in 2001 are the cut in the 15% rate to 10%, and a \$100 increase in the child credit.

This is not nearly enough. The goal of the Bush Administration was to stimulate faster economic growth with lower marginal rates to pay for more spending on defense, educa-

tion, and Social Security and Medicare reforms. The delay in phasing in cuts in marginal rates means they will generate much additional growth. The stretchout over years also dilutes the fiscal punch of the tax-cut plan. Reagan tax cut passed by Congress in 1981, at 3.4% of gross domestic product, gave back more than twice as much as Bush tax cut, at 1.4%. Moreover, that 1.4% is backlogged over 11 years so that, measured on a present-value basis, Bush tax cut shrinks even further compared with Reagan's.

That's too bad because Washington is going to need a lot more growth to generate more tax revenue in the years ahead. Bush's missile-defense system will cost some \$100 billion. The conventional defense buildup proposed by Defense Secretary Donald Rumsfeld will cost around \$200 billion. Eliminating the alternative minimum tax will take \$300 billion. And Medicare prescription-drug coverage could cost \$1 billion. Just maintaining the current level of spending on highways, criminal justice, education, and farm subsidies would add \$400 billion of spending over the next decade. Partially privatizing Social Security, as Bush promises, will cost \$1 trillion.

All of these spending pressures will rise in the years ahead. Without faster economic growth, it's fair to say that rising spending puts the Bush marginal-rate cuts in jeopardy. The danger is that sophisticated business managers and consumers who make the decisions that stimulate growth will conclude that they simply can't count on most of the tax relief promised by Bush. That uncertainty could further undermine the kind of economic growth that lower marginal rates are intended to stimulate in the first place. Bush tax plan points in the right direction. But simpler, deeper, earlier cuts would have been better.

ARE MERGERS PUTTING INNOVATION IN PERIL?

Vivendi buys MP3. France's Alcatel negotiates for Lucent. Switzerland's Novartis takes a piece of Roche. Germany's Bertelsmann buys Napster. Citigroup buys Mexico's Banamex. Vodafone takes a stake in Japan Telecom. Weyerhaeuser chases Willamette. First Union bids for Wachovia. Procter & Gamble buys operations from Bristol-Myers Squibb. A new wave of consolidation is washing across the globe, with concentration rising in industry after industry. There's nothing wrong with companies seeking scale, markets, products, or technology through buying each other, though studies show merged companies usually underperform the stock market. The real worry is that greater concentration will lead to less competition and innovation. This wasn't a problem during the merger boom of the early '90s. It may be today.

Here's why: Consolidation in the '90s took place within an economic ecology that included a surge of new, small, in-

novative companies that forced corporations to adapt to new technologies and ways of operating. Startup telecoms challenged the Bells, and Napster Inc. and MP3.com Inc. music sharing shook up the music industry. And so it went.

Now, mergers are taking place in a different environment. Big companies feast on the innovation of the past decade, and concentration is reducing the need to compete. Venture capital has dried up. And there are fewer small, startups to provide new ideas and pressure to improve products and services. This is just as true in Europe and Asia as it is in the U.S.

If the venture-capital drought is temporary, and entrepreneurial activity starts bubbling again soon, there won't be much to worry about. But if they don't, this latest surge in consolidation could lead to much less vigorous innovation and competition. And that will hurt growth in the long term.

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BusinessWeek

JUNE 4, 2001

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A REPORT ON ELECTRONIC BUSINESS

PERSONALITIES

Jeff Taylor of
Monster.com

WEB SMART

How Moen
Became the
Leader in Faucets

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A REPORT ON ELECTRONIC BUSINESS

Contents June 4, 2001

cover story

22 Wireless Woes

Telecom players big and small have gambled hundreds of billions of dollars on the wireless Web. But with many wireless startups already going off the air, executives from Stockholm to San Jose are worried that the new services may not generate enough revenues to cover costs

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Bring a razor. Drink scotch. Meet Lee Iacocca. Get hip to the Old Economy

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The problem with most dot-coms is that they play it way too safe

home page

Idiots Unveiled

While Oracle Corp. CEO Lawrence J. Ellison was feasting on software sales driven by his dot-com customers last year—at the peak they amounted to 10% of Oracle's revenues, now down to about zilch—he also was surreptitiously ridiculing the hand that fed him.

For 18 months, Ellison, along with CEO Mitchell E. Kertzman of Liberate Technologies, and venture capitalist David J. Roux, secretly ran the parody site Heyldiot.com, joining other dot-com satirists

such as iTulip.com, businesssucks.com, and itoi-let.com. "Heyldiot.com is your ticket to the Silicon-lined gravy train!" the graphics-rich site proclaimed. "Here's how it works: Heyldiot.com is tightly focused on selling just one product. Elegantly enough, that product is the stock of Heyldiot.com." Thankfully, no one went for the pitch.

Ellison recently came clean about who was backing the site. He confesses that he and his friends built and ran the

site themselves as the dot-com bubble became more and more mystifying. "It was madness," he says. At least they had the good taste to take the site down a few months ago, before mocking dot-com nuttiness became passe'. But other satirists are not amused. iTulip's creators say on their site that Heyldiot was a "blatant attempt...to muscle in on our racket selling Internet company parody stock online." Perhaps it's time Ellison launched a new site, say, earningswarning.com.

—Jim Kerstetter



Ellison says he helped run Heyldiot.com



Beet Yums, Anyone?

Motivated by letters from customers claiming that everything from Tofu Total to Chocolate Cheerios could be the Next Big Thing if only General Mills Inc. would make it, the cereal giant is giving consumers a shot at proving they're right. MyCereal.com, launched last November, lets consumers formulate their own cereal and have it delivered to their doorstep.

At \$1 per serving, the cereal is four times as expensive as the supermarket variety. But people can mix and match 100 different ingredients, yielding over 1 million possibilities. What have they come up with? Try Chocolatey Calci-yums!, a noxious mixture of chocolate, peanut butter, marshmallows, and macadamia nuts. The company swears this was sold to a grown woman. Then there's Last Mango in Paris and Soy Good For you. Mmmm. On second thought, just pass the Wheaties.

—Julie Forster

Nice Work If You Can Lose It

It has been tough times for tech and dot-com companies. Since January, 2000, some 400 companies have gone belly-up and at least 335,000 workers have lost their jobs. But whaddaya know—many departing bosses have still lined their pockets amid the wreckage. Here are some of the silkier purses salvaged from the sow's ear of the Internet bust.

COMPANY	FORMER CEO	OFFERED
Gateway	Jeffrey Weitzen	\$6.4 million
Priceline	Daniel H. Schulman	\$4 million*
WebMD	Jeffrey T. Arnold	\$4 million
Webvan Group	George T. Shaheen	\$3.2 million†
Covad Communications	Robert Knowling Jr.	\$1.75 million*

*Estimate of severance packages. May include cash, accelerated vesting of stock and options, and forgiven debt. †Estimates present value of 20-year retirement benefit that pays \$375,000 a year, assuming Webvan's continued existence. Data: Analysis of company proxies and CEO contracts by SCA Consulting for BusinessWeek e.biz



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BY ELLEN NEUBORNE

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The Box that Rocks

In-store kiosks really get customers clicking on retailers' Web sites

One hot day this spring, a neighbor wanted a big cooler to lug lots of food to a picnic. She checked at Kmart but didn't like the selection. It was, after all, Manhattan. There's not much demand for mammoth coolers in the urban jungle. Then a clerk suggested she try the in-store kiosk—a PC hooked to BlueLight.com, Kmart's e-tail Web site. Click to the cooler, the clerk said, and

it will be sent to your home in time for the picnic. My neighbor was impressed. "I didn't know Kmart had delivery," she said.

It doesn't. But BlueLight.com does. In fact, BlueLight has lots of things a shopper might like. And in that transaction, the in-store kiosk did more than sell a cooler. It sold the e-commerce site. Kiosks are "a powerful tool that connect Kmart to BlueLight.com," says Steve Chaffin, director of in-store marketing for BlueLight. It worked with my neighbor: She wouldn't have learned about the site otherwise.

Kiosks, once regarded as the low-rent customer service desk, are rising to a new role: pitchman-in-chief for the company Web site. Retailers have spent big on e-commerce, but they have no proven way to direct shoppers to their virtual stores. TV ads cost too much, banner ads don't bear much fruit, and you can generate only so much buzz plastering a Web address on bags. Kiosks bridge the gap between brick and click. "It's like training wheels," says Yankee Group analyst Kevin Noonan. "It makes the first-time customer more comfortable."

Retailers are starting to see the impact. Five months after installing 3,500 kiosks nationwide, Kmart reports that 20% of shoppers at BlueLight.com come from inside Kmart stores. That makes the kiosk army the second-strongest draw for the e-tailing site, behind only Kmart's free Internet service. Bookseller Barnesandnoble.com Inc. saw its first-quarter growth rate top rival Amazon.com Inc.—thanks in part to B&N's kiosks funneling sales to the site. Office-supplies superstore Staples Inc. says its kiosks are

helping lure store customers online. Other retailers are noticing: The number of kiosks hooked to the Web grew by 25% last year to 40,000 and is expected to jump at least another 20% in 2001, says Summit Research Associates Inc., a retail technology consulting firm.

Don't kiosks cannibalize store sales? Sure, at first. But there's a payoff, and it's a good one.

Shoppers who purchase both offline and online from a given retailer tend to buy more. When Recreational Equipment Inc. added an e-tailing arm and kiosks in its 60 stores, it made the cash registers ring. Customers who shop both online and in stores spend 22% more than those who buy only from the real-world outlets, says Joan Broughton, REI's vice-president of direct and online sales. The kiosks helped introduce store shoppers to the online experience. Kiosks have "become an essential tool," Broughton says.

Enlisting kiosks as marketers isn't always a picnic. For one, it's expensive. While the computers are relatively cheap, once you throw in maintenance, training, and networking equipment, the tab can run anywhere from \$3,000 to \$25,000 per kiosk, according to Yankee Group figures. Second, there's no guarantee consumers will flock to the machines. Gap Inc. is abandoning its experiment with kiosks because shoppers didn't use them enough to warrant the cost.

Kiosks may not be sexy, but they're a tool the store shopper understands. They can encourage regular customers to branch out and shop online, where they'll spend more and the merchant's costs are usually lower. In the long run, they may be the best way for brick owners to get their customers to click. ■





MANAGEMENT CRISIS

Roberta hears about
client crisis on way to
meeting in Tucson.
She goes back to office.
She misses her flight.
She misses her meeting.

CRISIS MANAGEMENT

Roberta hears about
client crisis on way to
meeting in Tucson.
She wirelessly accesses
crucial information from
company intranet.
Then she rallies her team
via e-mail.
She makes her flight.
Problem is solved by takeoff.

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communication



BY ROGER O. CROCKETT

roger_crockett@ebiz.businessweek.com

Pump Up that Volume

Listen up: By adding audio, Web sites can attract more visitors

Kent Anderson loves the chatter of commerce: clerks advising customers, registers ringing up purchases, mood music over the intercom. When he shops online, he misses all the hubbub. But as president of Macys.com, Anderson is able to change that. Now, visitors to his site can click to hear about the latest promotions, listen to an explanation of electronic gift certificates, or get guidance on how

to find just the right present for a loved one. Sound "keeps the site new and exciting," Anderson says.

E-commerce doesn't have to be quiet. Three-fifths of the Web's top destinations sport sound, from spoken instructions to quirky noises, according to researcher Jupiter Media Metrix. Half of these sites dish up music, and 64% feature voice clips—like America Online's trademark "You've got mail"—that give information about the company or its products. For Web merchants who haven't turned up the volume, here's some sound advice: As more users get speedy Net access, they'll demand ever-richer Web pages, including audio. "Sound is a wonderful enhancement to e-commerce," says analyst T.S. Kelly of research house Nielsen/NetRatings.

The Company Store has heard the news. Almost every page features a woman's voice explaining products, reminding you to look over your shopping cart before checking out, or reassuring skittish surfers about privacy policies. The idea, says marketing manager, Orestes China, is to cut down on the amount of reading visitors do. The approach is paying off. The new audio capability, added in November, has contributed to revenues jumping about 15% so far this year compared with the same period last year, China says.

Helpful hints from a soothing voice aren't the only means of sounding off. Voxxy.com, a site for teenage girls, treats visitors to whiz-bang sounds that help them navigate. You know you've found the chat room when you hear a ringing phone and cocktail party chatter. A heavy guitar riff announces the "rant" section. A revving car engine signals a

browser's return to the home page. "The sound on the site really captures your attention," says Jennifer L. Main, a Los Angeles 10th grader who visits Voxxy.com often. Audio has been a key factor in helping Voxxy.com boost its monthly visitor total to 150,000 in April, up from 70,000 in February, says founder Kristi Kaylor. And special sound events, such as actress Jennifer Aniston opining on relationships and romance in a live Web talk show, have increased traffic by 400%.

Nifty noises add muscle to brand-building as well. Check out Twix.com, where candy was never so audibly cool. Move your mouse over the smiling guy and he raps the words "chewy caramel" to a techno beat. Scroll to the girl and the chant changes to "crunchy cookie." "It makes me think Twix way more than a banner ad would," says Michael M. T. Wean, a creative director for kids' Web sites and a frequent online shopper. The music mix is such a draw that unique visitors tripled between June, when sound was added, and January, says Scott Hudler, Twix brand communications manager.

There's one danger: All the chatter can bug some surfers. "I don't always want a salesperson interrupting my shopping," says Wynne Schiera, a tech manager at a Chicago-area children's library. Sure, she could just turn down her speakers, but savvy sites let shoppers click off the sound altogether—something both Macy's and The Company Store do. Given the traffic that sites with sound are attracting, though, most Netizens seem to like the chatter of commerce as much as Anderson does. ●



Sound is becoming an online hit. Three-fifths of the Web's top 75 sites feature audio, mostly spoken instructions and background music. Here are the most popular uses of sound on the Web by the sites that use audio:

Product/corporate description:	73%
Promotional information:	27%
Ambience music:	23%
Navigation instructions:	7%

Data: Jupiter Research



- 1 This is the **FOREMAN**
- 2 That placed the **Order**
- 3 That went through the **Dealer**
- 4 That notified **Contracts**
- 5 That alerted **Manufacturing**
- 6 That checked with **Accounting**
- 7 That contacted **Shipping**
- 8 That sent the **Delivery**
- 9 That sealed the **Process**
- 10 That lives in the **Integration Software**
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BY JOAN O'C. HAMILTON

joan_hamilton@ebiz.businessweek.com

Howdy, Dot-Com Campers

Bring a razor. Drink scotch. Meet Lee Iacocca. Get hip to the Old Economy

Hey Sport! Whether your softball team is the only thing left of your dot-com or you work at Hewlett-Packard, Sun Microsystems, or other Silicon Valley stalwarts that are enforcing "mandatory vacations" to cut costs, odds are you're going to need some help filling your free time this summer. Despite the slowdown, Digital Lifestyle knows that techies are notoriously disoriented by Don't Bring

Yourself to Work Days. That's why we're coming to your rescue: Act now, and you can be a participant in our first-ever Old Economy Fantasy Camp.

Just as at those baseball and golf camps, you'll rub elbows with the greats. Talk the talk. Wear the uniform. You'll be drinking heavily at nightly receptions, but you won't be calling it networking. (New Economy jargon is frowned upon here.) Instead, you'll be calling it "drinking heavily at the nightly reception." But the best news is that instead of broken-down old right-fielders, we'll be bringing in Old Economy Hall of Famers: the Buffetts, the Iacoccas—hey, Ross Perot is gonna give the keynote: "Whadya Expect From People Who Call Themselves Dot-Commies and Yahoos?"

Not that we aren't hip: Old Economy prodigal son George Shaheen will be on hand hosting a New Economy pink-slip party. In fact, the former CEO of Andersen Consulting and online grocer Webvan Group will serve lots of tasty appetizers he grabbed on his way out Webvan's door.

You'll get reacquainted with ultraconservatively dressed Fridays. You'll learn that success for a CEO is about where you send your board of directors for fabulous boondoggles—not your dang employees. And in case you actually end up solvent again someday, we'll have a slide show of classic corporate-headquarter looks. It's time to paint over all those Gymboree colors and sell those ping-pong tables on eBay. Soon, you'll swoon at the smell of an old-growth mahogany conference table or the feel of executive-suite carpets deeper than the rough at Pinehurst.

What to bring: a razor (projecting retro-business competency begins with shaving off those goatees, boys); tattoo-cover-up crème; a notebook—not a notebook computer, but a real notebook, with lines and a curly wire hinge. Upon check-in, you'll be issued a gold Cross mechanical pencil with the logo of an Old Economy icon, such as Cargill or Cummins, welded onto the clip. It's the kind of benny employees used to receive only after 10 years of devoted service!

What to expect: In the first few days of camp, muscles you haven't been exercising for a while may feel sore—the areas of the brain controlling common sense, for example, and fiscal responsibility.

But the business equivalent of spirit guides from Alcoa, Chevron, and

GM will help you learn such ancient traditions as padding your expense account instead of paying your bills with margin loans. Don't worry, our tougher seminars, such as "Undoing Disintermediation" and "The Perils of Innovation," come later in the week, when you're better acclimated to Old

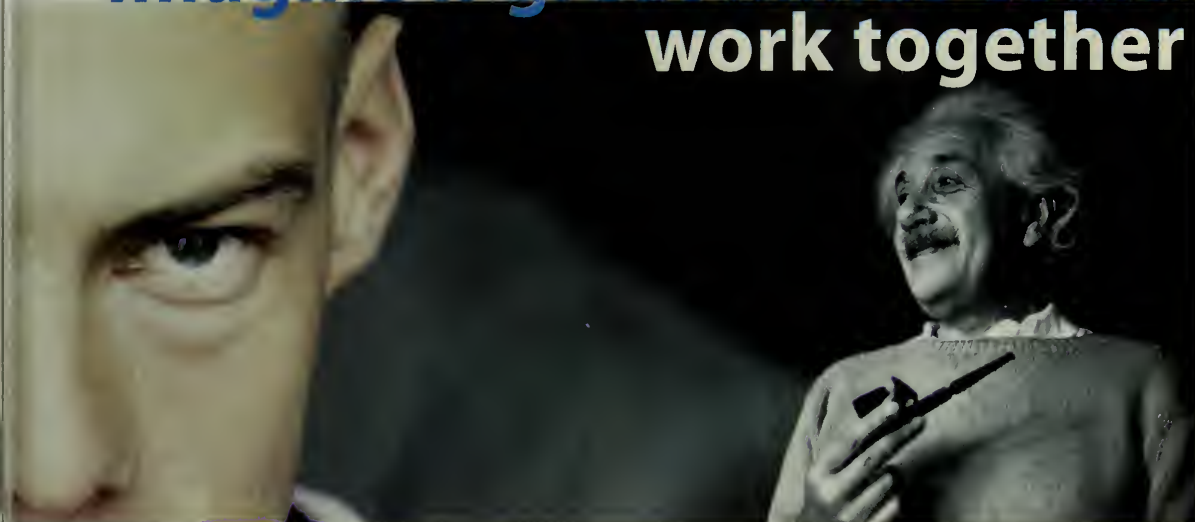
Economy thinking. Gals (and get used to us calling you that), it's no coincidence there won't be many of you.

The last night, we'll recreate the legendary bonfires of Bohemian Grove and cast

away New Economy cares. You'll have a double Scotch and smooth the wrinkles from your chalk-striped, summer-weight grey wool suit. The mere mention of 24/7 will amuse you as you savor the novel old notion of 6.5/4.5. Surely, our \$2,495 fee, excluding tips, is a small price to pay for getting in touch with your inner old economist. •



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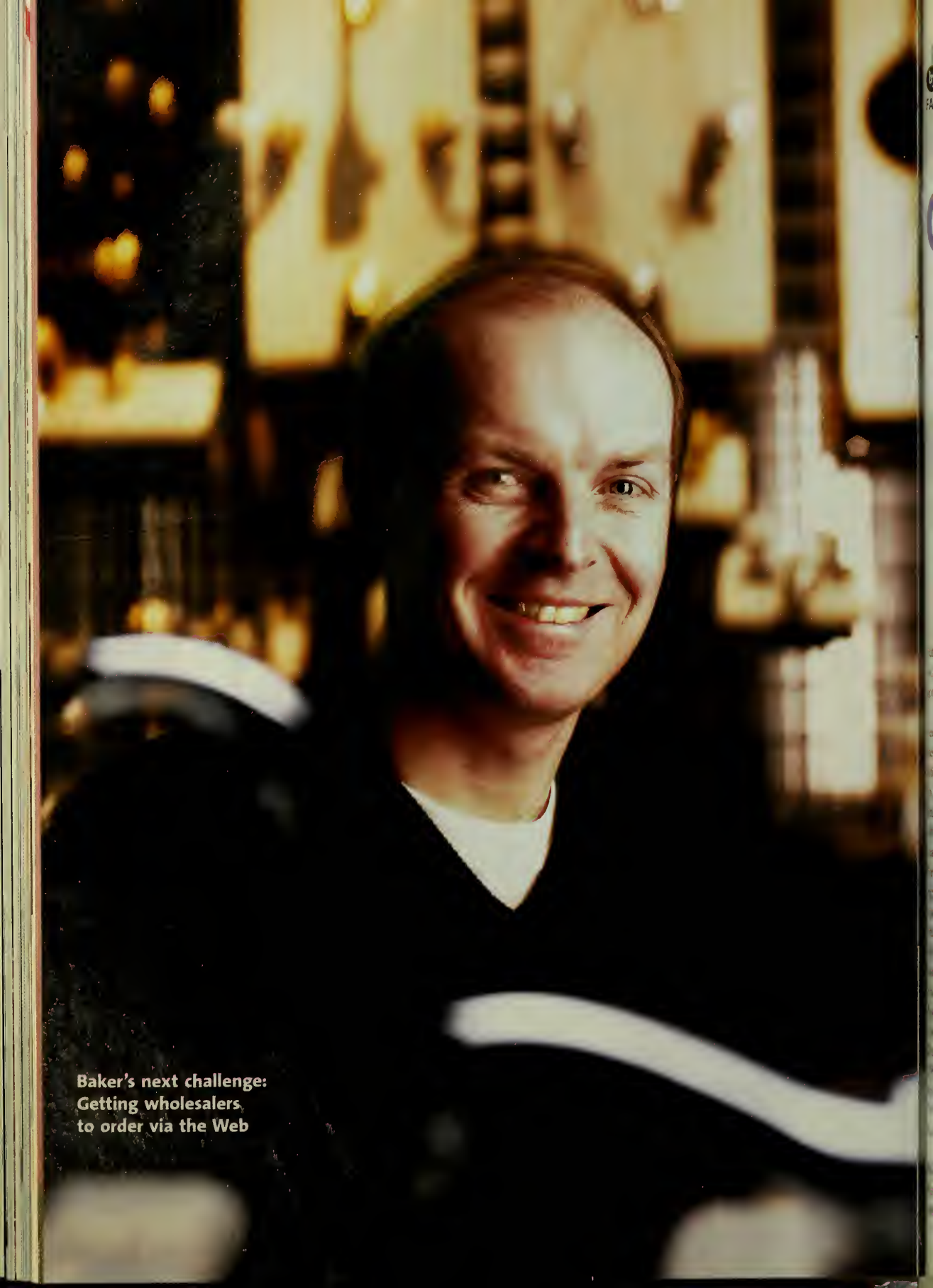
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A man with a receding hairline is smiling at the camera. He is wearing a dark V-neck sweater over a white collared shirt. The background is a dimly lit bar with warm, yellowish light from various sources, creating a bokeh effect. The overall tone is professional yet approachable.

**Baker's next challenge:
Getting wholesalers
to order via the Web**

by

FAITH KEENAN

Opening the Spigot

Faucet maker Moen uses the Web to streamline design. Rivals are eating dust

It used to be that if you were in the market for a new faucet, you could have any color as long as it was chrome. Plumbing fixtures were meant to be practical, not pretty. Then, in the mid-1990s, baby boomers started fixing up their homes or building huge new ones with gourmet kitchens and swanky bathrooms. Chrome got the cold shoulder. Goosenecks, gold, and built-in water filters got the welcome mat.

That's when faucet maker Moen Inc. decided it was really in the fashion business, selling jewelry for the bathroom and kitchen. The 54-year-old company needed to churn out new faucet designs in fresh finishes like silver, platinum, and copper as often as Donna Karan introduces a new ready-to-wear line. Moen President Jeffrey A. Svoboda calls it the "9-to-5" strategy. If consumers had a choice of new styles and were able to mix parts, they might buy a new faucet once every five years instead of every nine years. "We would double the size of the market and enjoy a gain in market share," says Svoboda, who spent 20 years at General Electric Co. and another three at Black & Decker Corp. before joining Moen in 1996. The only problem: Moen was selling many faucets designed in the '60s and '70s. The sleepy Midwestern company was lucky to introduce one new line a year.

Svoboda decided it was time to open the spigot. How? By using the Internet to design jazzy products—fast. Sure, everyone believed that the Web could help speed

communications, but few thought it could turbocharge product design and, in turn, manufacturing. Yet by collaborating on designs with suppliers over the Web, a new Moen faucet goes from drawing board to store shelf in 16 months on average, down from 24 months. The time savings makes it possible for Moen's 50 engineers to work on three times as many projects, and introduce from five to 15 fashion (er, faucet) lines a year.

The change is paying off handsomely. More products reaching the market faster has helped boost sales by 17% since 1998—higher than the industry average of 9% over the same period. Moen has jumped from No. 3 in market share to a tie for No. 1 with archrival Delta Faucet Co. Both claim about 30% of the \$2.5 billion North American faucet market. Now, Moen is the star performer in the lineup of its parent, Fortune Brands Inc., contributing one-sixth of its \$5.8 billion in 2000 revenues. "Better communication means more rapid deployment of ideas," says Svoboda.

That doesn't mean big budgets and

fuel-injected scheduling. Moen is taking the steady-drip approach to the Web. Since 1997, technology chief Tim Baker and his now 20-member Internet Program Office have been setting priorities, laying out what can be accomplished with the resources they have. So far, Moen's Web work has cost only \$1.5 million, with money spent to hire software developers for in-house work and on outsourced features like an online design room that allows customers to mix and match shower fixtures. This is the new model for an effective Net strategy, say consultants: methodical, with a focus on the bottom line. "Companies are starting to ask what's the return on investment and how strategic is the Web to their core business," says Tim Byrne, a vice-president at Mercer Management Consulting Inc.

Moen has known the answer for years. First, the company focused on clearing its own clogged pipes in product development. Moen's engineers typically work six to eight weeks to come up with the design for a new faucet. Until three years ago, they would burn that design onto CDs and mail the CDs to its suppliers in 14 countries that make the hundreds of parts that go into a faucet.

That's when it got tricky. Suppliers at times found they couldn't meet Moen's specs. So they would make changes, burn a new CD incorporating their suggestions, and send it back to Moen. The faucet





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maker would then combine the changes from all its suppliers. If some spec changes were incompatible with others, the whole process might start all over again. Going back and forth once would take two weeks. Doing it several times could extend the design process up to 16 weeks or longer. The extensa pull-out faucet, introduced in 1999, was so troublesome that it took 17 weeks just to finish the design. The \$294 faucet is a smash hit, selling in the hundreds of thousands of units.

Imagine sales if Moen had been able to get the extensa to market five months sooner. Svoboda did. That's why, in late 1998, Moen started sending electronic files of new product designs by e-mail. A few months later, it launched ProjectNet, an online site where Moen can share digital designs simultaneously with suppliers worldwide. Every supplier can make changes immediately. Moen consolidates all the design changes into a master Web file. That way, design problems are discovered instantly and adjustments can be made just as fast, cutting the time it takes to lock in a final design to three days.

Next, the company attacked the cumbersome process of ordering parts from suppliers and updating them by fax or phone. In October, the company launched SupplyNet, which allows parts suppliers to

check the status of Moen's orders online. Every time Moen changes an order, the supplier receives an e-mail. If a supplier can't fill an order in time, it can alert Moen right away so the faucet maker can search elsewhere for the part. Today, the 40 key suppliers who make 80% of the parts that Moen buys use SupplyNet. The result: The company has shaved \$3 million, or about 6%, off its raw-materials and work-in-progress inventory since October.

Moen's approach is like light speed compared with competitors. Many still rely on fax machines to do most of their business. The percentage of companies using the Net to speed the supply chain in the construction/home-improvement field, which includes plumbing, is expected to rise to just 7.7% in 2004, up from 3.2% in 2000, according to Forrester Research Inc. By comparison, the auto industry is expected to reach 26%, up from 6%, over the same time period. "Moen is a step ahead of its peers in embracing Internet technologies," says analyst Navi Radjou of Forrester Research.

A lot of the credit goes to Svoboda, who studied at the School of Improving Productivity Through Technology. That is, GE. Svoboda, 50, spent most of his career at the corporate giant, running manufacturing plants in GE's appliance division.

His marching orders were to cut out

the fat, speed products through the assembly line, reduce inventory, and free up cash for new investment. He has applied the same philosophy at Moen, only with an Internet twist. "Anything that could take time out of the process is a huge advantage for managing cash for the business," says Svoboda. "The Web is a natural."

Moen may be ahead of its peers, but there's plenty of work to do. Technology chief Baker's most sensitive task is CustomerNet, the company's attempt to wire wholesalers, which account for 50% of the company's business. Unlike suppliers, who depend on Moen for most of their business, the company has little sway with wholesalers that buy plumbing, heating, and other products—not just faucets—from many manufacturers. Most still order by fax, even though that process causes errors up to 40% of the time.

Moen execs are undaunted. They're courting wholesalers with the same methodical determination that has made Moen a Web-smart company. By the end of the year, they expect the trickle of online orders to turn into a steady stream, clearing the final blockage in the pipeline. ●

e.biz online

For a Q&A with Moen technology chief Tim Baker, visit ebiz.businessweek.com.

Faster Faucets

Turn the knob, and water comes out. How hard can that be?

In truth, it takes hundreds of parts to make a faucet. That's why Moen is using the Internet to cut the time it takes to get a new faucet on store shelves to 16 months from 24 months. Here's how:

FAUCET DESIGN	THE OLD WAY	THE NEW WAY
STEP ONE 	Designers send a CD with a drawing of a new faucet to parts suppliers worldwide, taking up to a week to reach them.	Moen posts the 3-D design of a new faucet on the Web, where all the suppliers have instant access to it.
STEP TWO 	If suppliers can't meet Moen's specs, they make changes and send a new CD to Moen, taking another week.	On the Web, suppliers can make design changes instantly. They don't have to wait to see if they work with other changes.
STEP THREE 	Moen works the changes into a new design. If the changes cause other problems, the process starts again. Time taken so far: up to 16 weeks.	Moen folds the changes into a master Web file. Adjustments can be made instantly. Time taken so far: two to three days.
STEP FOUR 	Suppliers make the tools to produce the parts. If they do not meet specs, they have to start over. Time taken: up to 24 weeks.	New laser tools and Web files are more precise, so the supplier gets it right the first time. Time taken: another four to five days.

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by

ANDY REINHARDT

Wireless Web Woes

Telecom players have
spent billions, but
profits are still far off

Tony Coyle was sure he had latched on to the Next Big Thing. In March, 2000, the 28-year-old British entrepreneur and his two mates launched a nightlife information service called Joe London. The company dished out up-to-the-minute reviews and event listings to cell phones using a technology that re-formats Web pages for mobile devices. But people balked at the slow, clunky system. After just three months of scant traffic, the founders pulled the plug. "We saw the hype and the hard landing," Coyle says.

So did a lot of others. Stockholm-based Citikey bored through \$16 million trying to launch mobile-phone city guides across Europe before cratering last November. Cre-Senda Wireless, a Los Angeles provider of software for linking business data from the Web to handhelds, bit the dust in February. British Internet provider Breathe.com took its last breath in March, partly due to an ill-advised push into wireless Web services. All faced similar complaints: Getting information through mobile phones was too darn slow, expensive, and confusing. "Expectations were out of whack

MICK WIGGINS



with reality," says Niklas Savander, general manager of the Internet applications group at phonemaker Nokia.

These wireless woes strike terror in the hearts of telecom executives from Stockholm to San Jose. The industry has gambled hundreds of billions of dollars on

their growth. Last year, European carriers laid out a staggering \$116 billion to license spectrum for speedy third-generation (3G) mobile systems, and they will have to shell out another \$150 billion over the next few years to build the networks. With that kind of money on the line, as well as

heavily to pay for their new licenses and have been crippled under the heavy debt loads. France Télécom, Deutsche Telekom, and British Telecom have \$130 billion in debt among them. The Netherlands' KPN may be in the worst shape: It took on \$20 billion in debt and now is

"Expectations were out of whack with reality," says the general manager of Internet applications at Nokia

the wireless Web becoming a booming success over the next few years. Now, the problems experienced by Joe London and other startups are raising serious concerns that the high hopes and big promises were little more than marketing fluff. Fears are growing that revenues generated from the new services may not repay the costs of providing them anytime soon.

Nowhere are the stakes higher than in Europe. The Continent's largest telephone companies bet their futures on a surge in wireless data services to propel

sky-high usage of cell phones, Europe is shaping up to be the testing ground of the mobile Internet. If it doesn't work in Europe, will it elsewhere?

Going haywire. Investors are worried that the experiment is going haywire. The stocks of some European telecom companies have dropped 50% or more since last year. Wireless giant Vodafone Group's shares, for example, have tumbled 54% from their peak last March. Worse, many companies have borrowed

selling off its stakes in 20 businesses to pay off its loans.

There's good reason to be nervous. The original vision of the wireless Web was the Internet in your hand: From a mobile phone, you could surf Web pages, scroll through articles in *Le Monde*, or buy the latest bestseller from Amazon.com. The potential revenues seemed limitless. However, recent studies from analysts such as Gartner Group Inc. and Jupiter Media Metrix Inc. suggest that customers aren't jazzed by many wireless applications and

The Wireless Web: Who Wants It?

Europe is the petri dish for wireless data. European mobile operators have pledged \$116 billion in license fees for zippy, next-generation networks that offer easier access to the wireless Web. Making that investment pay off looks questionable. Even by 2005, voice calls—not Internet services—will account for 60% of European wireless revenues. Here's the outlook for carriers:

Shipping Bits	R U Rdy 2 Spk SMS?	Location, Location, Location	Let's Play
On today's mobile networks, data charges are per minute, like voice. For 2.5G and 3G systems, charges will be applied per byte. That could boost wireless data access tenfold by 2003. WHO WINS? Carrying data will generate big revenues, but it's a commodity business subject to fierce price pressure. Operators will try to move to higher-margin information services and mobile commerce.	Short messaging—SMS—has yet to catch on in the U.S. But Europeans should zap 200 billion notes this year, yielding \$10.6 billion for carriers. By 2003, expect 1 trillion messages. WHO WINS? More messages doesn't mean surging revenues: In five years, competition will cut prices in half. By then, 10% of messages may have ads or paid content. But AOL, Microsoft, and others will grab some of the loot.	Mobile networks can pinpoint a caller's location and supply that info to providers of geographically targeted services. This raises privacy concerns, but some users will want instant driving directions or bargains from retailers. WHO WINS? Carriers could make billions. It's an even bigger opportunity for advertisers and content providers. And corporations can do fleet tracking and inventory.	From games to online gambling, fun will be big business. Online gamers and gamblers are flocking to mobile phones, and their numbers could surge when color screens and speedier data connections arrive. WHO WINS? Gaming sites and bookies will score most of the dough. But wireless operators should see some increased traffic and will take a small cut of transactions.
OUTLOOK: ↑	OUTLOOK: ↔	OUTLOOK: ↑	OUTLOOK: ↔
MARKET SIZE IN 2005 \$30.8 billion	MARKET SIZE IN 2005 \$12.3 billion	MARKET SIZE IN 2005 \$6.2 billion	MARKET SIZE IN 2005 \$13.6 billion
SHARE OF REVENUES 22%	SHARE OF REVENUES 9%	SHARE OF REVENUES 5%	SHARE OF REVENUES 2%

don't want to pay much for them. Rather, they want low-cost, simple-to-use services. For example, short messaging, online games, and targeted information based on your location are proving to be popular. Revenues per subscriber for these kinds of services will rise by more than \$6 a month by 2005, says analyst Lars Godell of Forrester Research Inc. But the increase won't make up for the decline in voice revenues caused by fierce price competition. Forrester forecasts a \$13 drop in monthly voice sales per subscriber in the same period. Overall, monthly revenues per subscriber are expected to fall from \$38 today to \$31 in 2005. "Mobile Internet revenues won't bridge the gap," Godell says.

Worse yet, they may not pay back the massive outlays for future networks. All told, the huge 3G expenditures will add, on average, \$5 a month per subscriber to the cost of providing mobile service for the next 15 years, Forrester says. Coming up with data services to drive so much incremental revenue will be tough. If carriers can't boost their take, they face financial ruin or massive consolidation.

The math is manageable for some mobile operators, murderous for others. Many countries, such as the Nordics and Spain, granted 3G rights via "beauty con-

tests" in which inexpensive licenses were awarded to operators that best met criteria such as rollout schedules and financial strength. Recovering an investment of \$112 million in Spain should be a breeze for a company like Spanish operator Telefónica Móviles, even if its subscribers pay only a few dollars per month for data services.

In countries that auctioned 3G licenses, such as Germany and Britain, prices went through the roof. In Germany, Telefónica partnered with Finland's Sonera to bid \$7.6 billion for a license and will spend at least \$4 billion more on its network. That \$12 billion will be hard to earn back for a company new to Germany. The venture, called Group 3G, is expected to see revenues of only \$1.3 billion in 2005, says brokerage Sanford C. Bernstein & Co. At that rate, Munich-based Group 3G might have to merge with a larger partner to remain viable, Bernstein says. "We're not worried about our financial situation," responds Group 3G spokeswoman Susanne Westphal.

U.S. telecom players face less financial risk, if only because they're moving to 3G more slowly. Most carriers are rolling out simple wireless Net services with the radio spectrum they already have. They probably won't bid on new licenses for 3G

GLOSSARY

Wireless Data Lingo:

WAP: Wireless application protocol, the current-generation mobile data technology that reformats Web pages to fit onto tiny wireless screens. Introduced in 1999, WAP services have been criticized for being slow and difficult to use.

2.5G: The next step in wireless data, set to launch this summer in Europe and next year in the U.S. The 2.5G systems send data separately from voice for delivery at least three times faster than current networks.

3G: Third-generation services let voice and data more efficiently share the airwaves and could be more than 10 times faster than 2.5G.

until late this year or next year—and then they're likely to be cautious bidders, after the European fiasco. "The stakes are quite small in the U.S., but the potential rewards are huge," says wireless analyst Tom Lee of J.P. Morgan Chase & Co.

Still, the story is far from what hypesters originally predicted. In 1999, at the peak of the Internet bubble, analysts forecast that a half-billion people would use wireless phones to get on the Web by 2003. Based on those expectations, hun-

Blasting Ads	E-Business	Shop Till the Line Drops	Daily Bugle On the Go
isting banner ads to cell ones doesn't work: Slow nnections and small screens make ads intrusive and hard read. But color screens and faster data rates with 2.5G and 3G could kickstart ads.	Calendars, address books, and e-mail are going mobile. Companies soon will link their job dispatchers, supply-chain tracking, and customers. A better flow of info could cut costs by up to 30%.	Spinmeisters envision mobile shopping, price comparisons, and auctions. But don't expect huge sales. Tasks best suited to mobility—say, buying tickets to a movie—will outpace most types of shopping.	People want traffic alerts, stock quotes, sports scores, and breaking news. WAP services, though, have been tedious. Faster 2.5G and 3G networks should boost demand.
WHO WINS? Ad prices are high now—up to \$225 per thousand impressions—but should fall by 90% within a few years. Content providers will keep the bulk of the money, with carriers getting about 25%.	WHO WINS? Carriers benefit from increased traffic, but software companies like Oracle, SAP, and Siebel will walk off with more than 70% of the business.	WHO WINS? Operators are unlikely to control more than half the transactions, which will net only about 3% in commissions or billing fees. Bigger winners will be retailers and e-commerce software makers.	WHO WINS? Info-on-the-go will spur some voice and data traffic, but carriers keep only 10% of content revenues. The real winners will be portals like Yahoo!, BT Cellnet's Genie, or Sonera's Zed.
OUTLOOK: 	OUTLOOK: 	OUTLOOK: 	OUTLOOK: 
MARKET SIZE IN 2005 \$5.2 billion	MARKET SIZE IN 2005 \$5.4 billion	MARKET SIZE IN 2005 \$16.1 billion	MARKET SIZE IN 2005 \$4.9 billion
SHARE OF REVENUES 1%	SHARE OF REVENUES 1%	SHARE OF REVENUES 1%	SHARE OF REVENUES <.5%

Data: Forrester Research, Durlacher Research, Jupiter MMXI, Probe Research, ARC Group

dreds of software and content outfits set up shop near wireless meccas such as Helsinki, Stockholm, and Silicon Valley. Venture capitalists poured \$8.3 billion into more than 400 European and U.S. mobile Net startups since January, 1999, according to researcher Venture Economics. Even as

phone to check the weather when sailing but shuns more elaborate services.

Still, the wireless Net isn't dead. As telecom players and providers of wireless data refine their approach, they are beginning to find services for which customers are willing to pay money. The

business plans to take advantage of today's slower networks. After Joe London bit the dust, Tony Coyle and his mates ditched WAP in favor of Short Message Service, or SMS, a simpler technology that allows users to zap brief notes to one another and is built into every digital phone. In March,

Services **unique** to wireless promise the most. "The premium we're selling," says Verizon's Strigl, "is mobility

late as the first quarter of this year, some \$500 million went to nearly 40 companies.

But the first attempts at the wireless Web proved disastrous. Joe London and others tried to create an experience like surfing the Net from a personal computer. They used a technology called Wireless Application Protocol (WAP) that reconfigured Web pages so people could read them from their mobiles. The result: excruciating waits for simple information. And mobile shopping? Unthinkable. The hostile reaction was dubbed "WAPlash." By the end of 2000, just 5% of Europe's 210 million mobile subscribers used WAP services. "The phone is not a surfing machine," says Kimmo Karppi, a Finnish software manager who uses his mobile

effort should become easier over the next year as European and U.S. carriers roll out an interim generation of wireless technology, known as 2.5G, that will move data about three times faster than today's poky 9,600-bits-per-second connections. Better yet, the data will be "always on," which means it will flow in and out of handsets whenever they're turned on. That's a big improvement over current networks, which require users to dial in to check a stock price or sports score. And it's a proven success, at least in Japan. There, a wireless Web service called i-mode has attracted 23 million users who each spend an average of \$18 per month.

Impatient startups aren't waiting for zippier technology. They're revising their

the trio introduced a new service, called mTickets, that lets customers buy movie and club tickets via PCs on the Web and receive confirmation via SMS on their mobiles. Then, with phone in hand, users flash the screen at the box office and breeze in the door. "It's really a great service," says Nicole Bailey, marketing manager for London's Prince Charles Cinema, which has signed up to use mTickets. Coyle is in discussions with giant Ticketmaster about a possible licensing deal.

"Value added." True, such simple messaging schemes barely tap the interactive potential of the Net. But they're cheap to implement and might well add up to big money. By 2003, predicts investment adviser Durlacher Research Ltd., Europeans will dispatch more than a trillion SMS messages a year, generating annual revenues of \$12 billion for carriers. Better yet, as many as 8% of those messages might carry paid content—either ads, which could cost marketers 3¢ to 5¢ each, or infograms such as stock-price alerts paid for by subscribers. Commissions and fees from such "value-added" messages will drop an additional \$2 billion annually into the laps of carriers by 2003, predicts Forrester.

Once the higher-speed 2.5G and 3G networks kick in, mobile operators will rake in billions just from moving bits. The business of giving customers wireless access to their corporate networks or the Internet should make up some \$25 billion annually in 2005, by far the largest chunk of carriers' data revenues and 22% of their overall sales, predicts Forrester.

Such services, though, may not produce the profits mobile operators seek. That's because messaging and data transport are commodity businesses subject to price competition and customer turnover. To escape that trap, carriers are scrambling

Roadmap to the Wireless Web

1998 ▶ First release of Wireless Application Protocol (WAP), a standard for delivering data to mobile phones.

1999 ▶ Japan's NTT DoCoMo introduces i-mode, its own wireless data technology. Grows to nearly 5 million users by yearend. Analysts predict 500 million wireless Web users worldwide by 2003, sparking investment frenzy. Hundreds of wireless startups funded.

2000 ▶ Early WAP phones and services are disappointing and sales are slow. "WAPlash" sets in, and startups begin to fold. European operators pledge \$100 billion for licenses to build new third-generation (3G) networks, which should be more than 30 times faster than today's systems.

2001 ▶ Interim generation mobile service—called 2.5G—set for fall launch in Europe. Will allow faster connection speeds. DoCoMo delays by six months its 3G service, now scheduled for November. More startups fold.

2002 ▶ Scattered upgrades to 2.5G in the U.S.; broader rollout in Europe.

2003 ▶ 3G scheduled to hit Europe and the U.S., but few expect widespread adoption until 2005. Analysts now forecast fewer than 200 million wireless Web users by yearend, although nearly 600 million are expected to use simpler data services such as messaging.

Data: ARC Group, BusinessWeek, and company reports



Coyle's first mobile venture lasted three months

to stake out positions in emerging sectors such as mobile commerce, advertising, and content that could help them differentiate themselves, build customer loyalty, and net higher margins. For instance, operators are licensing content from outfits such as Reuters Group and CNN and setting up wireless portals.

The payoff may come slowly. Delivery of news, sports scores, and the like "won't be much of a revenue generator for carriers," says Nick Henry, European vice-president for Seattle-based Web publisher InfoSpace Inc. The reason: Consumers get news free on the Web and won't want to pay for it on its wireless cousin. Better 2.5G and 3G networks could help by allowing for richer content spiced up with audio and graphics. But European carriers will see only \$600 million in content revenues in 2003, researcher Datamonitor predicts.

To boost the take, carriers are likely to look for sponsorship deals. But that's no sure thing given that Web advertising has been iffy. Still, companies like Washington-based Spotcast Communications Inc. and Germany's Mindmatics have sprung up to deliver ads using SMS. They argue that different

rules will apply in the wireless sphere. One Mindmatics promo offered discount coupons from German health-products e-tailer VitaGo.de to 5,000 WAP users. The result? Nearly 10% responded—20 times better than an average Web banner ad—

the site. Anders Hakfelt, managing director of Mindmatics' British office, credits the difference to personalization: Wireless subscribers typically elect to receive ads and provide demographic information in exchange for freebies such as coupons. That could help drive wireless ad revenues in Europe to \$430 million in 2003 and \$5.8 billion in 2005, predicts Durlacher.

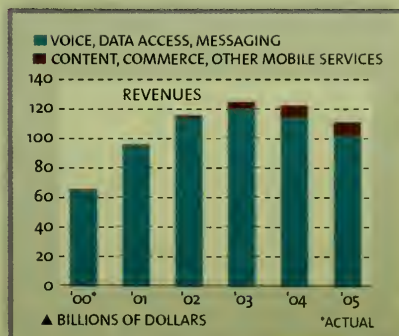
The most successful data services will be those unique to wireless. "The premium we're selling is mobility," says Denny F. Strigl, CEO of U.S. giant Verizon Wireless Inc. None is more promising than so-called location-based services, which exploit the ability of mobile networks to pinpoint the whereabouts of each phone. Using such data, Zurich-based startup Cinergy offers local schedules for movies all over Switzerland. Such services should become more useful when improved location technology rolls out in concert with 3G. By 2003, predicts The Strategies Group, operators will book \$2.5 billion from selling data on users' whereabouts. The ability to pinpoint the location of each phone is "a fundamental strategic asset for carriers," says David A. Pearce, European marketing director for SignalSoft Corp., a Colorado company that feeds subscriber coordinates from a dozen operators to more than 180 commerce and content clients, such as Cinergy.

The wireless Internet is unlikely to be the bonanza its supporters once hoped for. As far out as 2005, mobile content, commerce, and other services will generate only \$9 billion in revenues, according to Forrester estimates. While some large telecom players and innovative upstarts may fare relatively well providing simpler, stripped-down services, weaker players such as KPN and Group 3G may end up swamped by the billions they're paying for licenses and networks. Many carriers "will never get the license fee back," says Bernstein analyst Andrew J. O'Neill. The best companies could emerge from the shift to 3G more powerful than ever. But plenty of blood will be spilled along the way.

Contributing: Peter Elstrom and Steve Rosenbush

Diminishing Returns

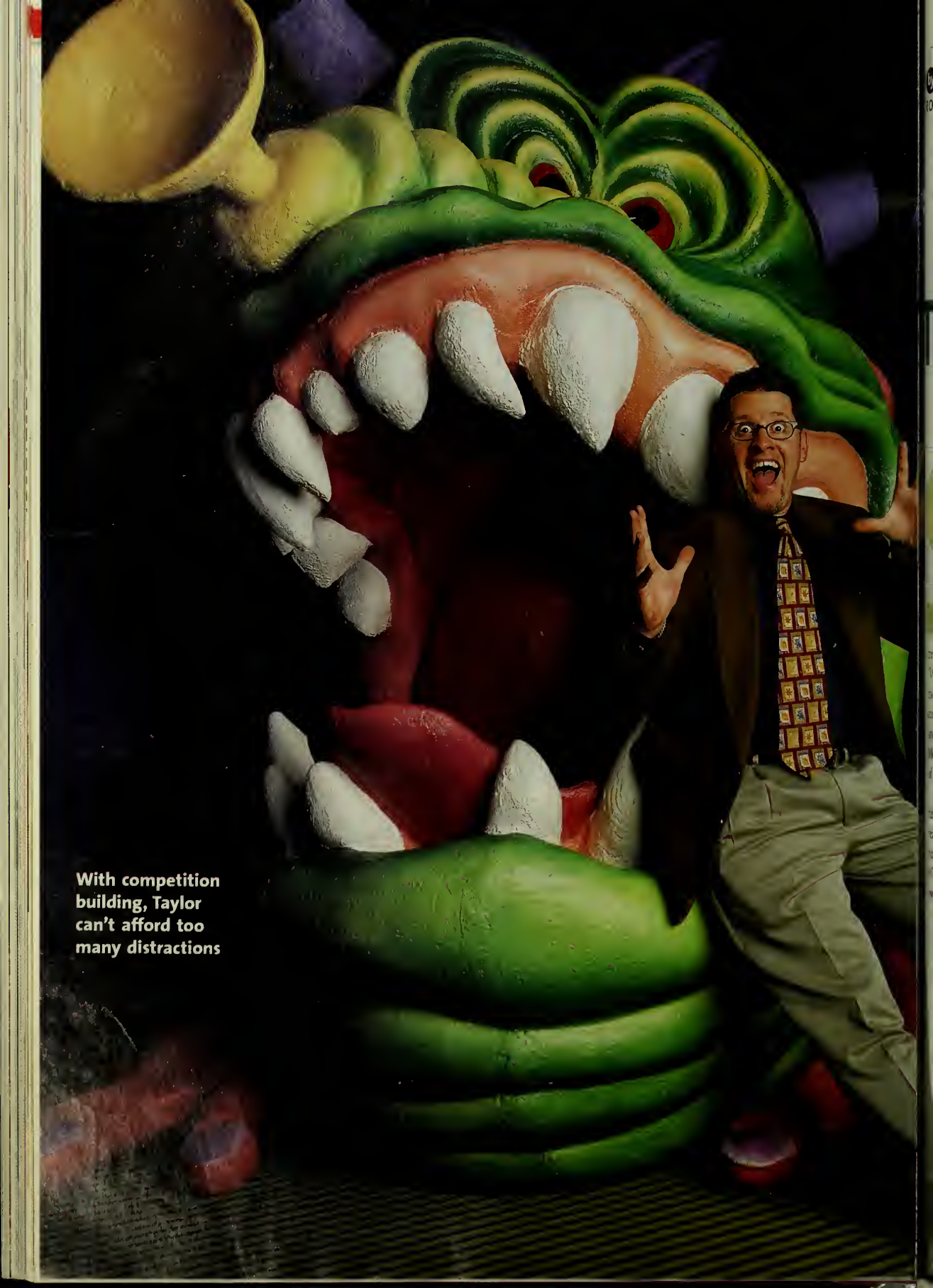
European carriers' voice, data access, and messaging revenues are expected to peak in 2003, then start falling as the market gets saturated and prices drop. The carriers hope to make up the difference with new information services, but those won't be big enough to stop the slide, let alone provide overall growth.



Data: Forrester Research

e.biz online

For a look at the success of Japan's i-mode, go to ebiz.businessweek.com.

A full-page photograph featuring a man in a dark suit, a patterned tie, and glasses. He is standing next to a massive, green, cartoonish mouth that is open, showing large white teeth and a red interior. The man has a wide-eyed, open-mouthed expression, looking directly at the camera. The background is dark, and the overall scene is surreal and humorous.

With competition
building, Taylor
can't afford too
many distractions

by

ROCHELLE SHARPE

The Life Of the Party

Can Jeff Taylor keep the good times rolling at Monster.com?

Standing in a massive ballroom at the glitzy Westin Hotel in Boston last year, Jeff Taylor, the brash CEO of Monster.com, exhorted more than 300 employees at his company's annual sales meeting to join him in an off-color chant. "The roof. The roof. The roof is on fire," he bellowed, singing a song

frequently used by nightclub deejays to pump up their crowds. "We don't need no water. Let the motherf----- burn. Burn, motherf-----, burn." Now, he brushes off the smattering of complaints he heard from employees. His motivational ploy, he says, "was just frickin' great." It pounded home the message that Monster.com, the world's biggest job-search Web site, is at the top of its game, and it revved up the salespeople to defend their turf.

The episode was quintessential Taylor: unconventional, fun-loving, borderline offensive, yet effective. This 40-year-old college dropout turned marketing whiz has built the world's leading online recruitment site. With 10 million résumés, Monster.com holds sway over 34% of the market for online recruiting—more than double the share of its nearest competitor, HotJobs.com Ltd., according to Jupiter Media Metrix Inc. What's more, while other online outfits rack up losses, Monster has been profitable for 12 consecutive quarters. In the most recent quarter, ended Mar. 30, it generated \$32.5 million in operating profit on \$129.2 million in revenue. That accounted for 35% of the revenue of its parent company, TMP Worldwide Inc., a New York employment advertising and executive search agency.

But there's a downside to a CEO being the life of the party. While Taylor's fraternity-like antics leave many people laughing, some former employees find his behavior upsetting. William O. Warren, who resigned as

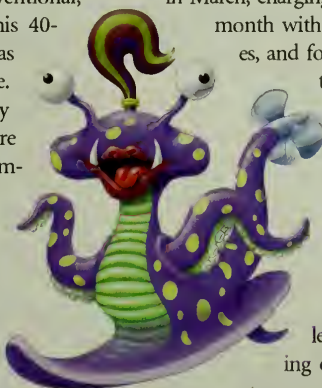
Monster's president in 1999 and is now CEO of a rival company, wowemployers Inc., says 18 Monster employees joined his firm this year in part because of the "hedonistic" working conditions at Monster. One of the defectors, Gina Esposito, former human resources manager at Monster's In-

dianapolis office, calls Monster's atmosphere "sordid." She says she was offended by the way Taylor looked at her and kissed her on the cheek. Also, she says, he danced closely with employees at parties, which is "totally inappropriate for a CEO."

Taylor says he's astounded by the complaints. He prides himself on creating a friendly workplace. And he dismisses his critics because they work for wow, which TMP Worldwide sued in March, charging theft of trade secrets. The suit was settled last month with Monster agreeing to pay wow's legal expenses, and former Monster employees agreeing not to contact their Monster clients for a year. As for the dancing, Taylor says he simply matches employees' dance styles: "If somebody wants to dance funky and close, I'll dance funky and close." And he kisses women on the cheek "almost out of respect. It's not out of disrespect.... It's my way of saying: 'I care about you,'" he says.

Taylor is more concerned about the challenges facing Monster. With the economy cooling off, rivals getting savvier, and some corporate customers annoyed by Monster's fees, its domination of the market may be hard to maintain. Monster makes its money by charging corporations up to \$300 for each help-wanted ad but lets individuals post their résumés for free. The company not only faces competition from other big online job boards but also must defend itself from 35,000 or so specialty sites that can provide a more targeted pool of job candidates for less money.

The business is changing rapidly, too. As the online-recruit-



ing industry matures, companies are looking for a single solution to all of their hiring needs, including software that helps sort résumés, test applicants, and conduct background checks of job candidates. The race to create such a comprehensive package has just begun, but it could make

ter than most online job boards because it gets 40% of its revenue from its rapidly growing overseas businesses. And the company has started buying firms that will allow it to provide more recruitment services, such as résumé sifting. On June 1, Monster is going to launch MonsterTRAK,

"If somebody wants to dance funky and close, I'll dance funky and close"

large online job boards like Monster seem like dinosaurs. Already, companies are hiring online recruiter BrassRing Inc. to search lots of specialized job sites simultaneously and automatically select the best-qualified applicants.

While most analysts view Monster as unstoppable, not everyone agrees. Analyst Matthew Litfin of William Blair & Co. in Chicago recently downgraded the stock to "hold" because of the economic slowdown. Since February, Monster's job listings have dropped more than 10%, from a high of 505,000 to 443,775 in mid-May. The company's deferred revenues grew only 3% last quarter, compared with 20% in the previous quarter. That's because corporate customers are signing shorter-term contracts, so less of the payments spill over into another accounting period.

Taylor says he isn't worried. He believes Monster can weather the storm bet-

a service aimed at matching college students with jobs.

While Taylor tinkers with operations, he has no plans to change his style. Even though he's the father of three, he sometimes parties late with employees, deejaying their private parties, and dancing the night away. After such events, he says, he can literally see morale jump. "Everybody has a little bounce in their step," he says. He recently bought a 1954 tugboat that he plans to use for company outings. Taylor wants a culture with a "high fun quotient," says Sales Vice-President Peter Blacklow.

Taylor fancies himself a younger version of Richard Branson, chairman of Virgin Group Ltd., whom he praises as an "adventurist." Both companies own blimps, and when Branson challenged Taylor to go waterskiing behind the Monster blimp, Taylor accepted. He handily beat Branson's previous record, skiing for 3.3 miles, vs. Branson's 1.5 miles, last year in Panama City, Fla. Says

Branson: "He's a great people person, and he enjoys working hard and playing hard."

Doing unusual things has been a trademark of Taylor's life and career. The son of a guidance counselor and a preacher active in the 1960s peace movement, Taylor spent his grade-school years in a community in Peoria, Ill., that was so poor there were no team sports at his school. Later, when the family moved to a suburb of Boston, it was too late for Taylor to participate in team sports, which his mother, Kay, believes wound up making him more of an individualist. "He has, never been in the mainstream," she says. For instance, he learned to tie elaborate flies for fishing when he was in 7th grade, insisting that his parents stop when they passed roadkill so he could fetch feathers and hair for use in his lures.

He was also outgoing. He became a popular paper boy because he befriended many people on his route. He was raised in a tightknit family—meeting weekly to discuss pressing issues and always starting the sessions by singing a family song they had made up. Those were the days Taylor learned to play the guitar and became passionate about music.

He took a while to find his way in life. He drifted in and out of the University of Massachusetts for six years, driving a truck after his freshman year, then returning to school and starting his own



JEFFREY CLARK TAYLOR

Born: Oct. 4, 1960, Aurora, Ill.

Education: Dropped out of the University of Massachusetts at Amherst in 1984 after six years of on-and-off studies. He plans to get an undergraduate degree this spring through UMass' University Without Walls program.

Career: During the 1980s, worked as a deejay at Boston nightclubs. He then created ads for Massachusetts recruitment firm, JWG Associates. In 1989, Taylor started ad and recruitment agency Adion. Looking for ways to find more job applicants, the idea of an online recruiting service came to him in a dream—literally. In 1994, he launched Monster Board, one of the first online recruiting sites. He sold it a year later to TMP Worldwide for \$900,000 and remained as CEO.

Management philosophy: He believes leaders

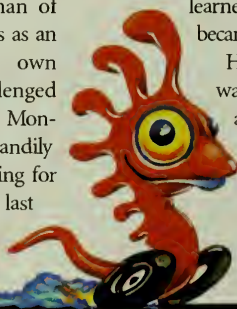
must make work fun. That's why he has a giant statue of his company's monster mascot in the lobby, and he sponsors lots of employee parties. "We have a work-hard, play-hard atmosphere," he says. Some staffers think the drinking and dancing go too far and quit to form a rival company.

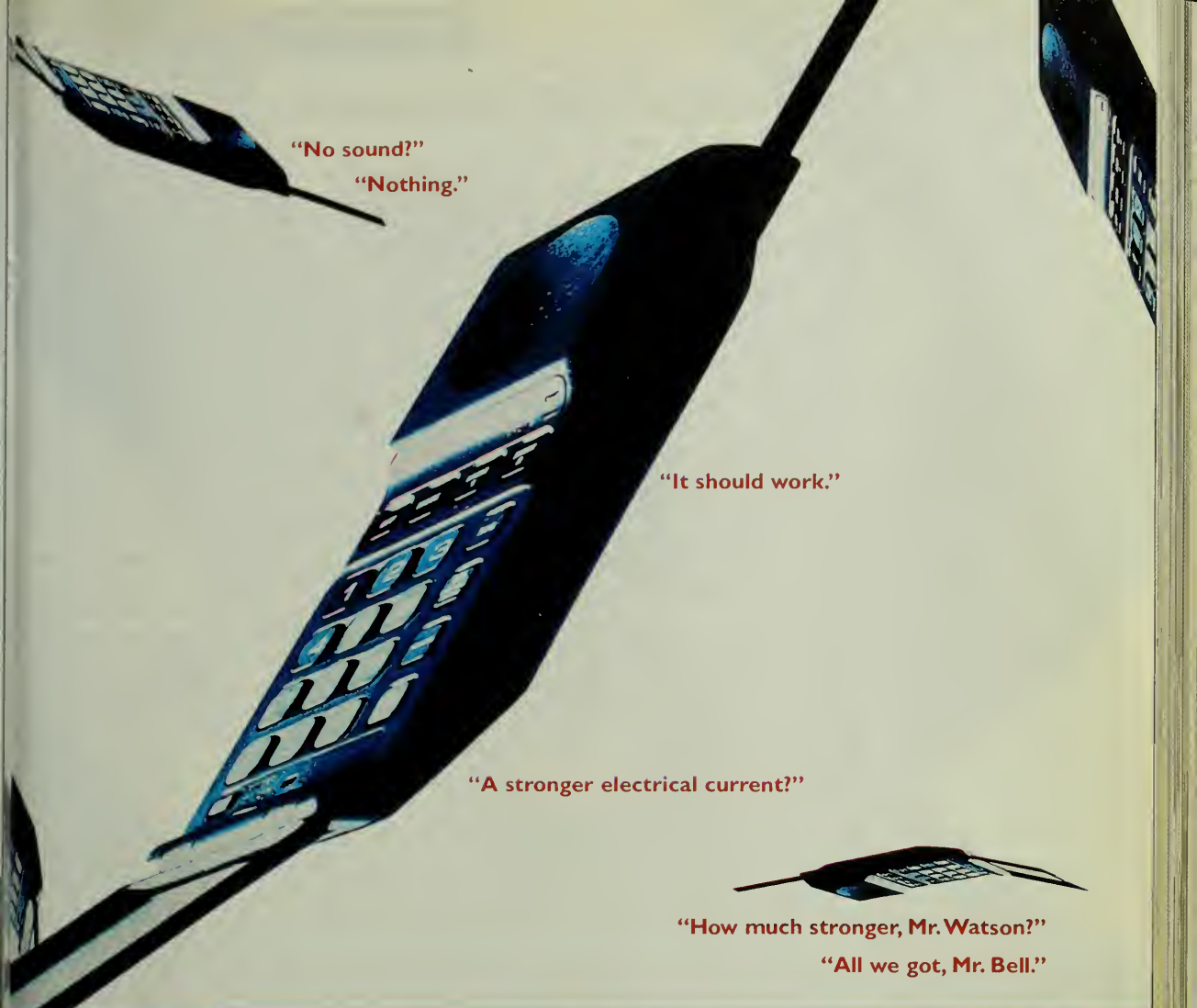
Hobbies: As a former deejay, he spins records at all company parties. He holds the Guinness world record for the longest-distance waterskiing behind a blimp: 3.3 miles, in Panama City, Fla., in 2000. He shattered Richard Branson's previous record of 1.5 miles.

Trademark formal wear: Tuxedo jacket with black leather pants.

Dream Job: Labor Secretary.

Family: He and wife, Janet, have three children: Ryan, 12, Brooke, 10, and Cole, 6.





"No sound?"

"Nothing."

"It should work."

"A stronger electrical current?"

"How much stronger, Mr. Watson?"

"All we got, Mr. Bell."

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Unisys Set to Score at the Upcoming U.S. Open

As any professional golfer would tell you, that winning stroke comes down to a little luck and a lot of precision. Most CEOs would likely say the same about implementing successful business information systems — especially when those information systems are responsible for providing millions of golf fans with scoring information for one of golf's premier events, the U.S. Open.

For 18 years, Unisys has been the only company to provide real-time scoring data for this elite event. And this year will be no different. "From the first putt to the last, Unisys scoring systems are working behind the scenes at Tulsa's Southern Hills Country Club to provide fans and media with access to relevant statistics over the Web," says David Fox, Director of Sports Marketing at Unisys Corporation.

So how does Unisys provide the media with the continuous stream of scoring facts and figures needed for their stories and for live TV and radio commentary? Here's how it works. Scores and other statistics are entered directly into wireless electronic data entry devices on the course and collated at the central site. The data is then communicated throughout the entire tournament site on color PC workstations and, at the same time, to the Web.

Unisys has done this since 1984 and is proud to provide scoring again at this year's 101st U.S. Open Golf Championship June 14-17.

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business selling freshman "survival kits" — complete with toothbrush, candy bar, map of the campus, and bottle opener. He spent some summers working as a dishwasher in Maine, where he developed an interest in advertising. He spent his spare time creating flyers that promoted local entertainment. He also learned how to deejay. After he quit school in 1984, he spun records for several years in Boston clubs. That brought out the party animal in him, says his mom.

Finally, he decided to try advertising as a career. It appealed to him, he says, be-

A Monster BASH

Even though Monster has been profitable for 12 consecutive quarters, CEO Jeff Taylor must tackle several big challenges to maintain his lead in the online recruiting market.

► Fierce Competition

Monster.com is the gorilla of online recruitment, but there are 35,000 other such sites, some specializing in specific industries and locations. HotJobs, its closest competitor, issued a Pepsi/Coca-Cola challenge to Monster to see which job board is more effective, but Monster declined.

► The Slowing Economy

Companies are expected to become more selective in their hiring and more price-sensitive. Since a job posting costs \$300 on Monster, vs. \$100 on many niche boards, corporations may take their business elsewhere.

► Disgruntled Customers

Customers complain that too many other companies have access to Monster's 10 million résumés. And TMP, Monster's parent company, has been buying staffing companies, prompting clients to worry that TMP firms may get early access to new résumés.

► Changing Demands

Companies realize they need much more than job and résumé listings. They want their online recruiters to sort through résumés and track applicants through the hiring process.

cause it allowed him to create something. He quickly became a star. At his first ad job, at JWG Associates Inc. in Needham, Mass., where he sold ads and organized ad campaigns, Taylor created energy and excitement and "turned the company into what it is today," says Linda Rappaport, now JWG's chief operating officer. He often played music at work and joked around, making late nights feel "almost like summer camp."

Within three years, he founded a recruitment agency for high-tech clients, Adion Inc. He soon started hearing people complain about how hard it was to find qualified candidates from classified ads in the newspaper. He thought a lot about the problem, he says, and one night, the solution came to him in a dream: an online job board for his clients. When he awoke he immediately scribbled some notes on a piece of paper, which now hangs in a frame on his office wall.

That led to Monster Board, which he launched in 1994. One year later, he made a move that others considered crazy: He sold his business to TMP for a mere \$900,000, staying on as CEO. That now seems brilliant, because it provided him with the money to spend heavily on advertising, including ads during the 1999 Super Bowl. He paid \$4 million for three 30-second ads. Until then, Monster had averaged 600 job searches a minute. On the evening after the ads aired, it was logging 2,900 a minute. Ultimately, the play attracted millions of job seekers.

Now he has to protect his successes. Some customers are getting fed up with Monster's high prices and business practices. Tech consultant Advancia Corp. in Oklahoma City recently switched from Monster to HotJobs because many of Monster's résumés are either anonymous or posted by staffing agencies that require employers to pay hefty commissions of up to 30% of a hire's annual salary. With former employees, fickle customers, and rivals nipping at its heels, Taylor will likely find that maintaining his monster lead will be tougher than building it. ●

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For a profile on William Warren, Monster's former president who is now heading rival WOWemployers Inc., go to ebiz.businessweek.com.

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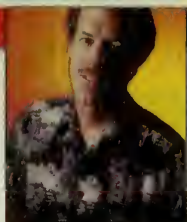
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BY ROBERT D. HOF

rob_hof@ebiz.businessweek.com



Let's Get Crazier!

The problem with most dot-coms is that they play it way too safe

Everyone knows why all those dot-coms crashed and burned: They had a bunch of crazy ideas that would never work. Bzzzzt! Wrong answer. The truth is, they weren't crazy enough. Now that the downturn has scraped the veneer of cool off every e-business from Yahoo! Inc. to Amazon.com Inc., it's apparent that they are all too normal, borrowing old business models that worked on television and in the

mall. To succeed on the Net we need twisted, cockamamie notions that just might have a chance in this nutty new world.

Three years ago, almost everyone thought eBay Inc. was a crazy idea: How many people really want to buy cars and boom boxes, let alone used cribs and diet pills, from someone they've never met, halfway across the country? The skeptics even included future Chief Executive Margaret C. Whitman, whose friends doubted her sanity when she took the job in early 1998. Now, eBay hosts a profitable \$5 billion worth of transactions annually, more than any other dot-com. Its execs and backers recognized that the seemingly kooky idea worked perfectly on the Net, where people could form a uniquely self-sustaining global marketplace.

By contrast, most dot-coms have clung to products and services companies offer in the physical world, often without adding enough value. Maybe it's a little easier to order groceries from Webvan Group Inc. than drive to a supermarket, but not so much so that Webvan can charge enough to make a profit. Yahoo does a great job of aggregating information, but its business model so far has been selling ads to the masses—hardly an innovative idea.

The problem now is that few investors want to hear any crazy talk. Maybe you can't blame them. The line between imagination and lunacy was mighty thin in the last couple of years. So now, venture capitalists, who are supposed to take risks, are shying away from funding any e-commerce company that looks the least bit risky. "The very creative ideas are not getting funded right now," admits Warren J. Packard, a managing director with the venture-capital firm Draper Fisher Jurvetson.

Fortunately, some entrepreneurs haven't checked out of the asylum yet. Take Karl Jacob, CEO of the online-advice service Keen.com Inc. After a short stint as an entrepreneur-in-residence at Silicon Valley VC firm Benchmark Capital—where he admits he didn't believe

in eBay at first—Jacob started Keen. His aim was to get people to log on to the Web to locate experts on everything from astrological readings to computer repairs—and then pay to consult with them over the phone. Weird as it sounds, it's working so far.

Sales at the privately-held company have jumped from almost zero a year ago to more than \$5 million in the first quarter. Says Jacob: "You can't create lasting companies and great value by following everybody else."

Or listen to E-Loan Inc. CEO Chris Larsen, who talks about person-to-person lending over the Web. The online loan broker may eventually help people invest in real estate loans in their neighborhood or in trusted members of their Kiwanis Club, bypassing middlemen in between. Sound crazy? Maybe, but it's what local savings and loans did before they got greedy and stupid. And the Web can create much broader communities, matching investors with loans of appropriate risk and return.

Even Amazon, while rightly cutting costs in hopes of earning an operating profit by yearend, still hasn't stopped innovating. It keeps releasing new features, such as an honor-payment system so customers can volunteer a few bucks to keep other sites they like in business. A lot of folks think it's nonsense, but Amazon gets a cut—and a chance to make its Web payment service a standard that could bring in big bucks in the future.

I don't know if any of those ideas ultimately will fly. But with a disruptive new technology such as the Net, intuition—backed by intestinal fortitude—often wins out over safe bets. "There's a lot of opportunity for more creative ideas on the Internet," says John Hagel III, author of *Net Worth* and *Net Gain*. Entrepreneurs and investors just need to find that backbone under the shirts they lost. ♦





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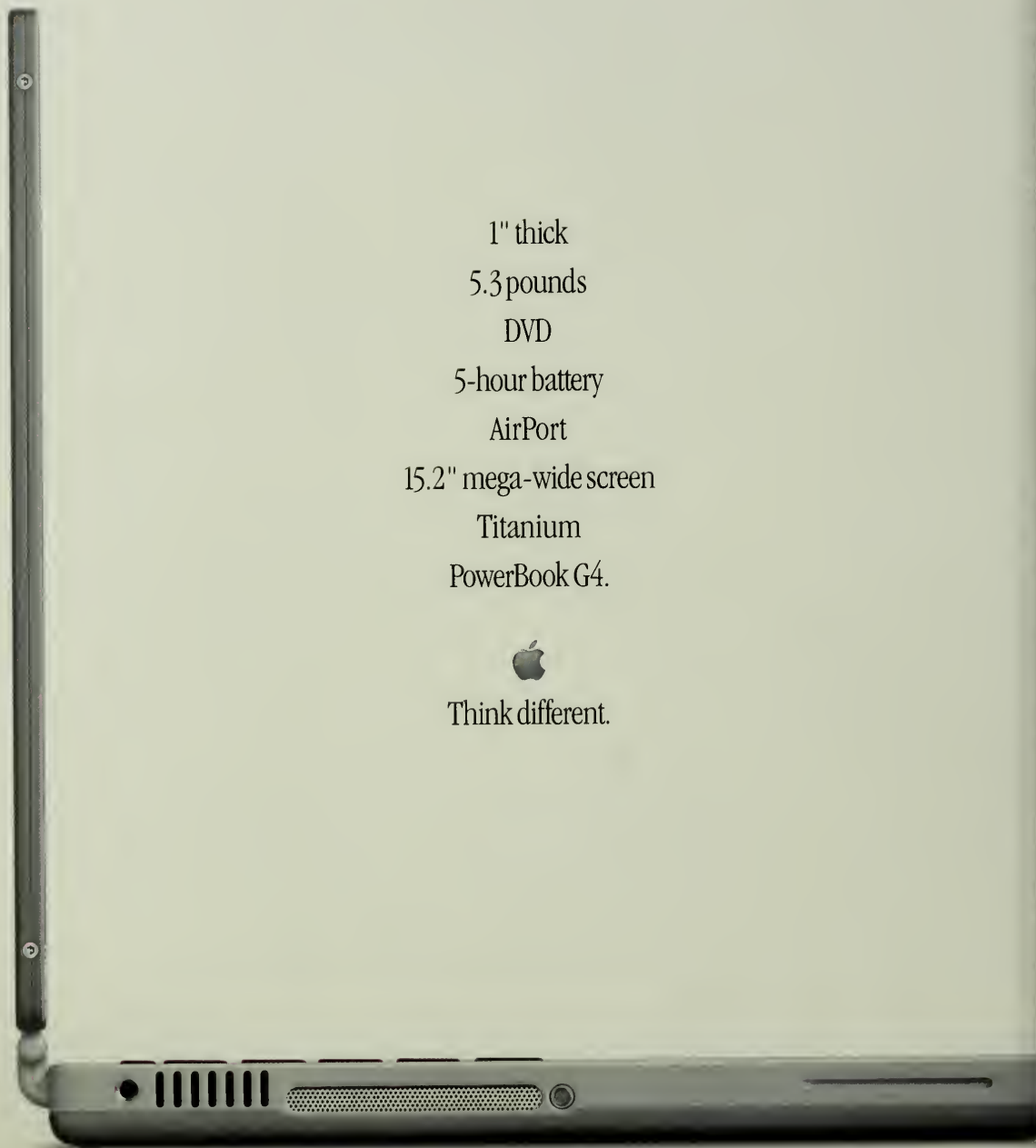
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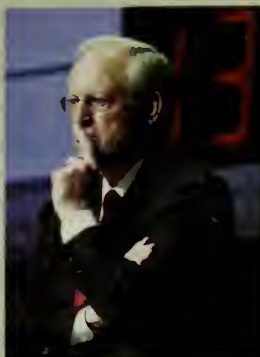
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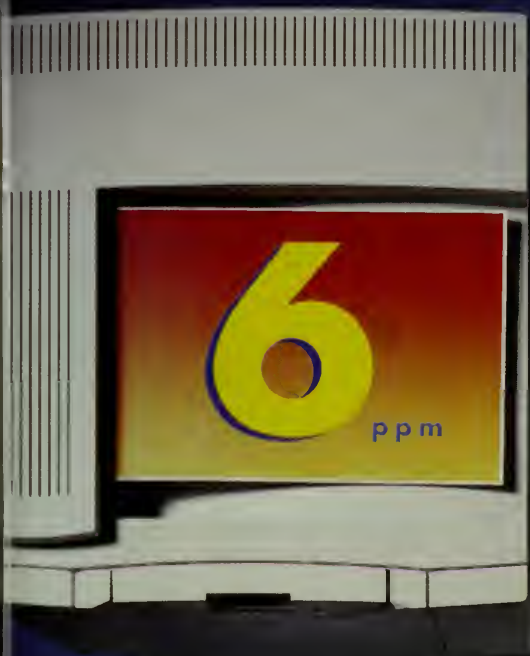
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Up Front

EDITED BY SHERIDAN PRASSO



I-WAY PATROL

WORKERS, SURF AT YOUR OWN RISK

CYBERSLACKERS, BEWARE! E-mail and Internet monitoring by employers is on the rise now that replacements for Internet abusers are plentiful in the soft labor market.

And that means firings on such grounds—mainly viewing porn sites, trading stocks, or posting to chat rooms—are up, too. Websense, a maker of Internet monitoring systems, found one out of three companies surveyed reported terminating someone for

Net abuse, a 10% increase over last year. "Employers cannot overlook the impact on productivity," says report co-author David Greenfield, noting that 70% of Net surfing is done at work.

Since the downturn, companies including E*Trade and JDS Uniphase have become converts to monitoring software, says Websense's Ted Ladd. Many companies that had relied on managers to check monitors are now users. "We're trying to ensure a healthy workplace," says Frank Gillman of Los Angeles law firm Allen Matkins, which recently upgraded its system.

E-monitors scan for keywords and note when something questionable is sent or viewed. Says Rob Spence of Ireland's Baltimore Technologies: "If I want to screen every outgoing e-mail that has the word 'résumé'...I can do that." So think about who's watching before hitting "send." *Ann Therese Palmer*

UNREAL ESTATE

EUROPE'S NEW EXPORT: BIG CHEESES

SERGE TCHURUK, CHAIRMAN of France's Alcatel, wasn't the only one disappointed when his talks to acquire Lucent Technologies broke down on May 29. Manhattan real estate agents were, too.

Tchuruk likely would have joined the invasion of Euro moguls relocating to New York to oversee their companies' U.S. expansions. In May, Andreas Schmidt, CEO of Bertelsmann's eCommerce Group moved to an Upper East Side apartment with his family.

NEW YORKERS:

Messier and Schmidt

An even bigger media heavyweight, Jean-Marie Messier, CEO of France's Vivendi Universal, will soon move his wife and five kids into a \$17.5 million Park Avenue duplex Vivendi bought for him. Messier says he wants to be closer to Wall Street and positioned between Vivendi's film and music properties in California and its TV and telecom operations in Europe.

Messier can get tips on where to buy croissants from his neighbor, retail tycoon François Pinault, who is spending more time in New York since buying Christie's auction house three years ago. *Carol Matlack*



TALK SHOW "At some point—one hopes sooner rather than later—the high-tech correction will abate"

—Federal Reserve Chairman Alan Greenspan, meeting with economists in New York

THE LIST AOL TIME WARNER'S POWER TOWER

It's just steel beams and decking right now, but the \$1.7 billion headquarters of this media-merger giant, due to open in 2004, will tower over a corner of New York's Central Park. Here are the details:

THE BUILDING Twin towers of 55 floors, anchored to an 11-floor base; 2.1 million sq. ft.

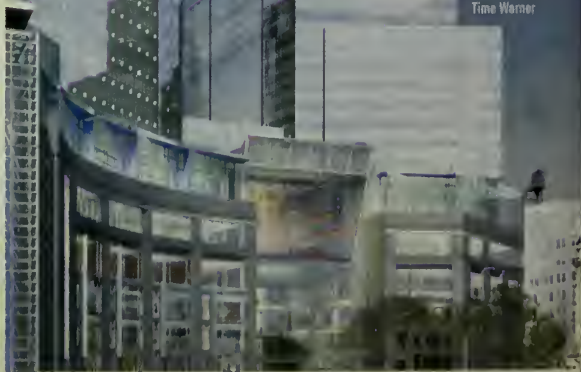
WHAT'S INSIDE Corporate headquarters, CNN's New York bureau, a five-star hotel, leased offices, condos, an upscale retail atrium, Jazz @ Lincoln Center.

WHO'LL BE WHERE Corporate offices in the South Tower (floors 12-21), with execs to be allocated space later this year. Production and broadcast facilities on lower and base floors.

ARCHITECTURAL "WOWS"

- CNN's 98,000-sq.-ft., glass-encased broadcast facility on the 8th floor will have 24-ft. ceilings and three-dimensional jutting windows.
- A 150-ft.-tall building "prow" will showcase a sculpture.
- Distinctive lanterns will top each tower.
- A showcase 11th floor will stretch across the towers' base and include screening rooms and a conference center.

Data: Related Companies, HLW International, AOL Time Warner



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Up Front

TELECOM TALES

CALL 'EM BRAIN-CELL PHONES

FOR THOSE WORRIED ABOUT the health debate over whether mobile phones harm the brain, a Hong Kong researcher has good news. Tatia M.C. Lee, a University of Hong Kong psychology professor, can't say for sure whether they do or don't. But her team of researchers recently compared people who use cell phones with those who don't. And they found that the brains of cell-phone users seemed to be a bit, well, swifter than those of nonusers.

AS THE DOWNTURN TURNS

COULD GASOLINE pass \$3 a gallon this summer? For Fast-Ad, a sign maker in Santa Ana, Calif., that prospect has been good for business. President Guy Barnes says that since early May, gas stations have been ordering "3"-point signs—a large "3" followed by a decimal point, which allows the cents to fluctuate—priced at under \$100.

Fast-Ad, a small player in the \$7 billion sign industry, has been in business for 37 years without ever fielding an order higher than a "1"-point. But after months of selling "2"-points, "3"-points are the order of the day. "We've sold hundreds of them," says Barnes.

Despite the new sales, Barnes isn't necessarily thrilled: "I drive an SUV, and it doesn't get very good mileage."

Lorraine Woellert



HEADY: Are users smarter?

Lee's theory is that exposure to the electromagnetic fields emitted by mobile phones may help people concentrate better. Moreover, people who spend a lot of time using cell phones are used to doing other things at the same time—and therefore may be better at multitasking as a result. Her study, published in the March edition of British journal *NeuroReport*, tested whether cell-phone users were more quick to match symbols or connect dots while coping with visual "interference," or distractions. One test measured how long it took respondents looking at the word "blue" printed in brown ink to say the word correctly. In another test involving connecting points with pencils, mobile-phone users showed significantly faster results—about six to nine seconds (or 17% to 19%) faster, on average, than the nonmobile-phone users, the *NeuroReport* study found. But, Lee points out: "People who are better able to divide their attention might use mobile phones more."

Lee studied 72 high school students, half of them cell-phone users—because in mobile-mad Hong Kong, "it's almost impossible to find non-mobile-phone users once people enter their 20s." While the study doesn't resolve the medical issue, it does show using a mobile phone may be a smart choice.

Bruce Einhorn

DRAWN & QUARTERED



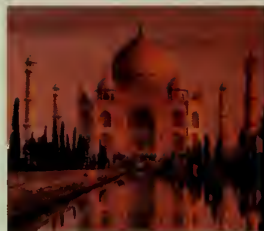
INDIA INK

NOW YOU CAN ADOPT A MONUMENT

INDIA'S CROWN JEWEL, THE Taj Mahal, is about to get a corporate caretaker. In June, New Delhi—which has been enlisting the private sector to help maintain its more than 5,000 historical sites—will pick a company for the honor. The short list includes the Taj Group of Hotels—an arm of India's \$8.4 billion Tata Group

spend \$500,000 on restoration—and get only good publicity in return.

India, with an annual budget of \$30 million for monument main-



TATA MAHAL? Fixer-upper

—which takes its name from the 17th century site.

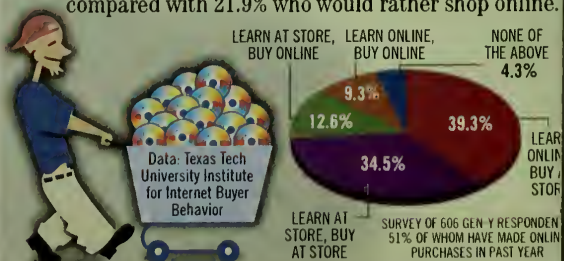
Spruced up for Bill Clinton's visit last year, the Taj Mahal had been deteriorating because of pollution and neglect. Taj Group would

ment maintenance, needs at least 10 times that to do the job properly, says Abn Grover, the archaeological survey of India conservation rector. "We're inviting anyone who is willing to come forward now," he says. "Later on, we may become choosier." With 12 monuments adopted so far, 4,988 to go, that may take while. Manjeet Kripal

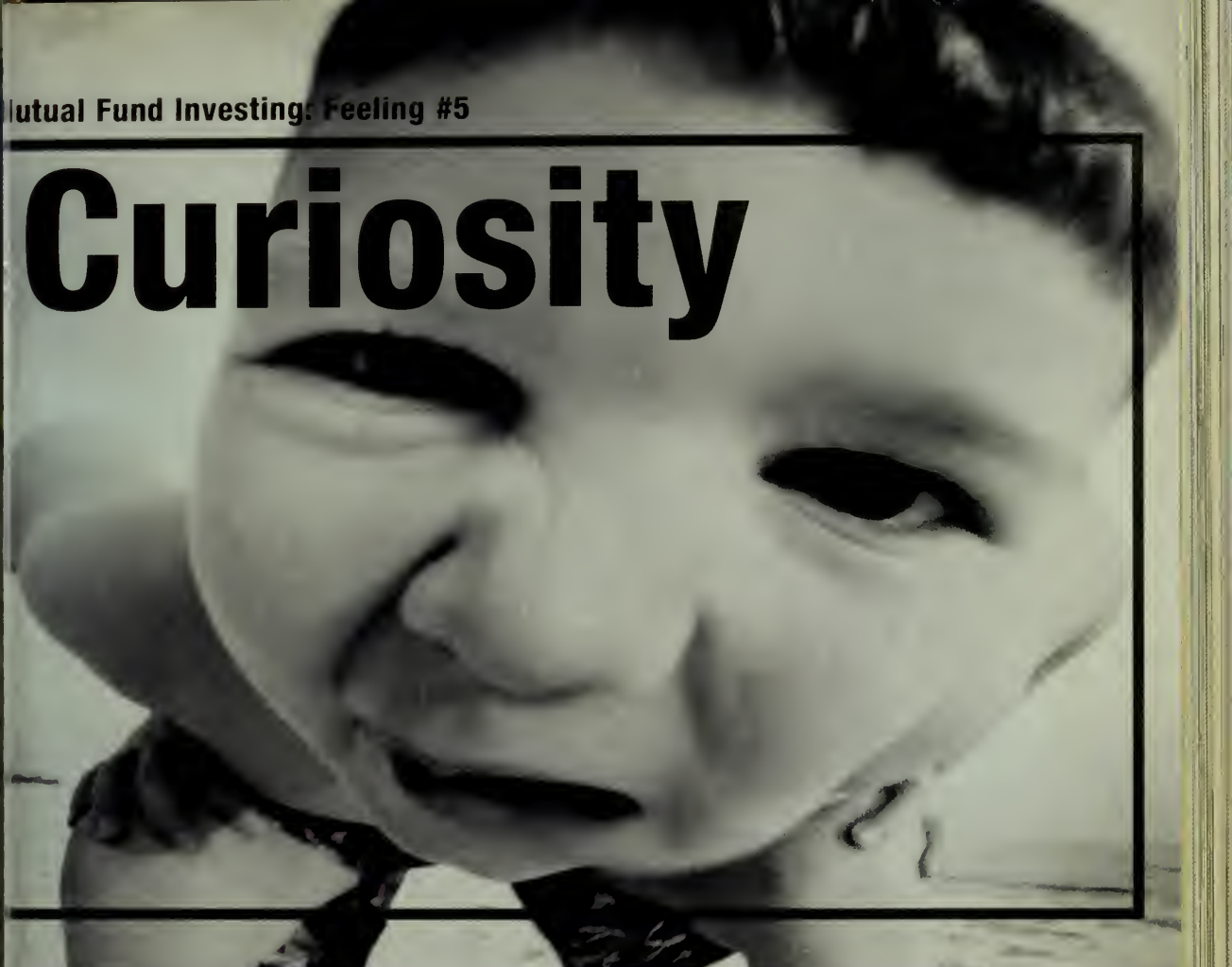
THE BIG PICTURE

IS GEN Y SHOPPING ONLINE?

Even the tech-savvy Generation Y (age 18-25) prefers handling the merchandise before closing the deal. When asked where they shop, most (73.8%) say they prefer stores, compared with 21.9% who would rather shop online.

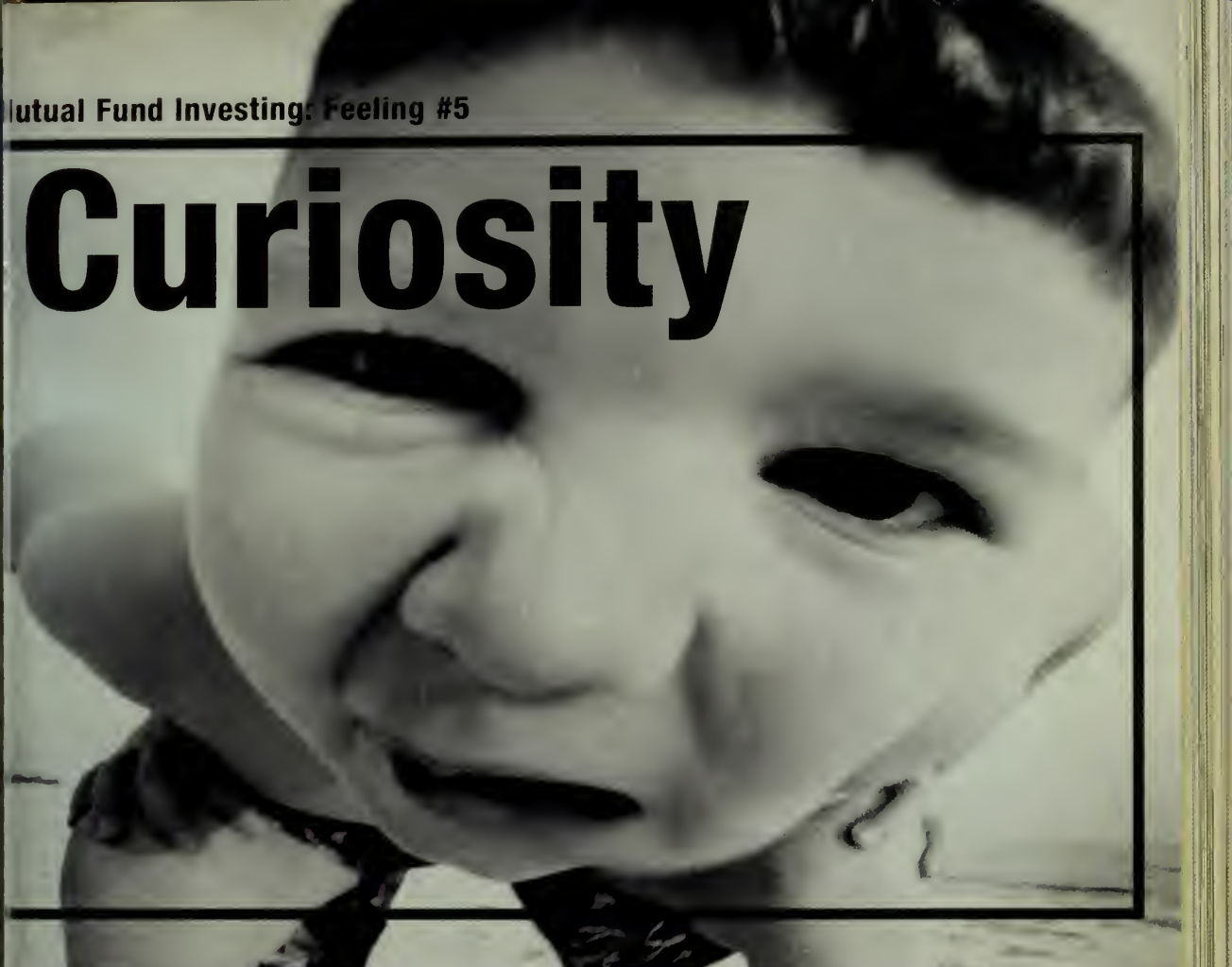


FOOTNOTES The increase in the number of female CEOs at 500 top companies, 2001 vs. 1997: **100%**. Actual number in 2001: **4**



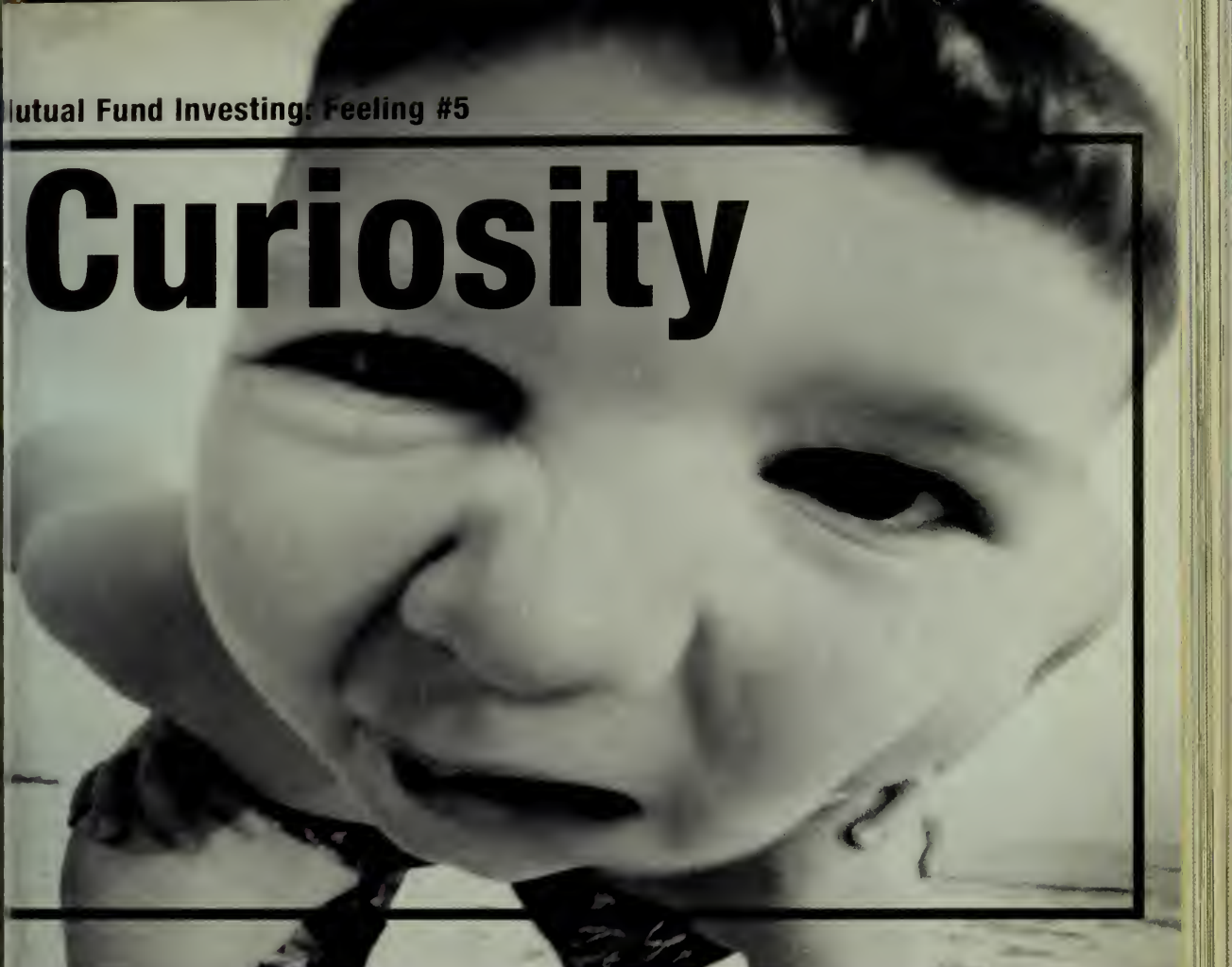
Mutual Fund Investing: Feeling #5

Curiosity



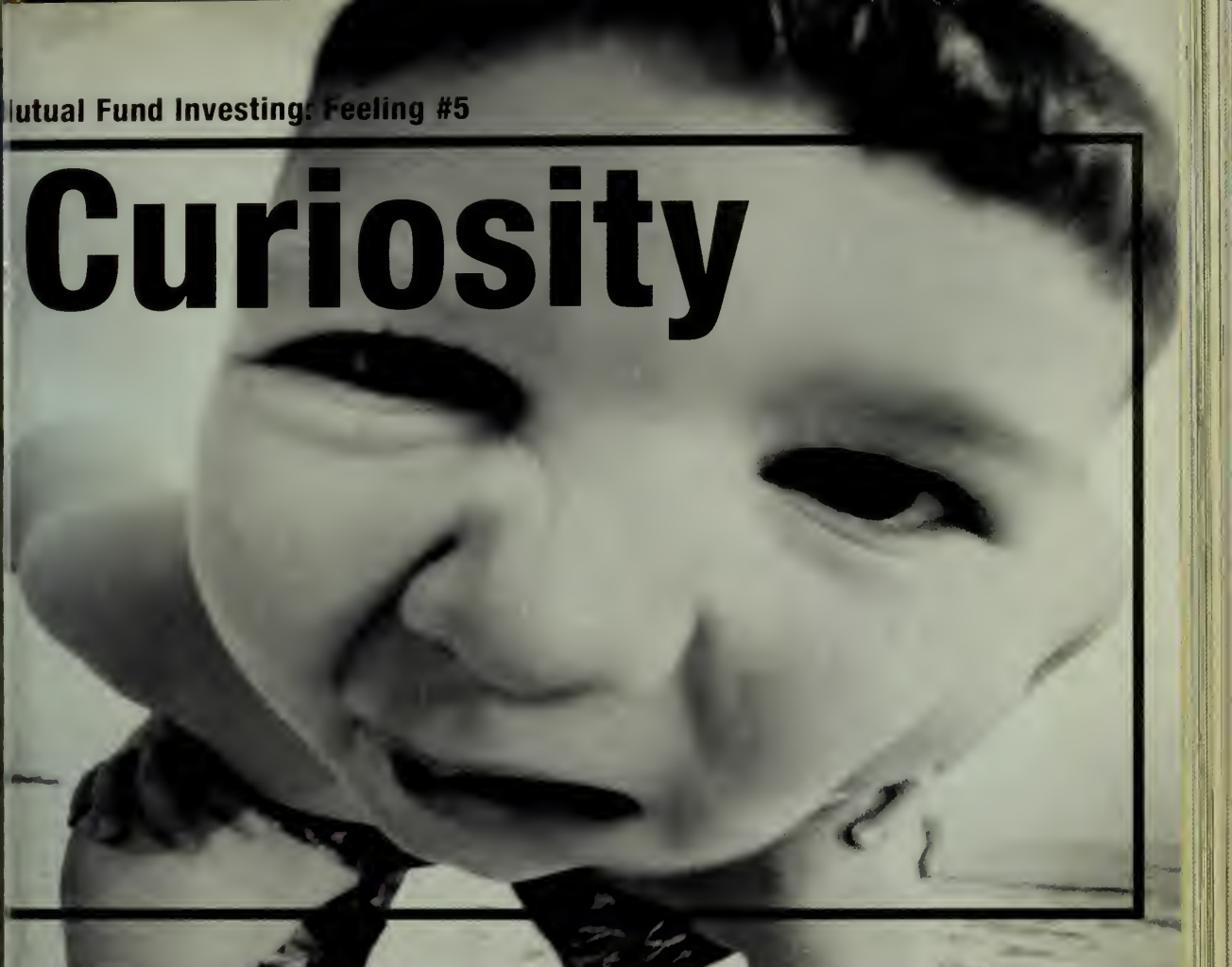
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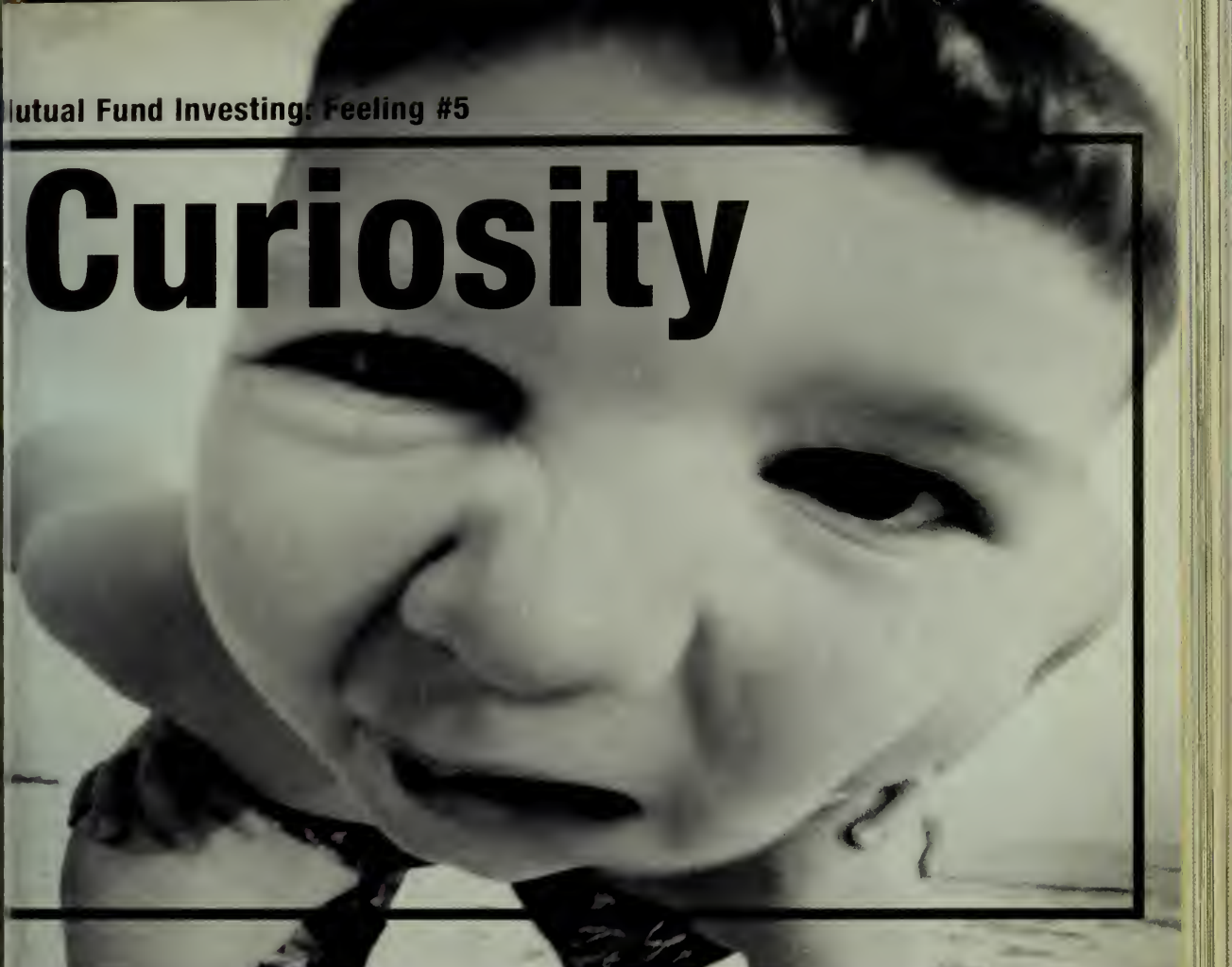
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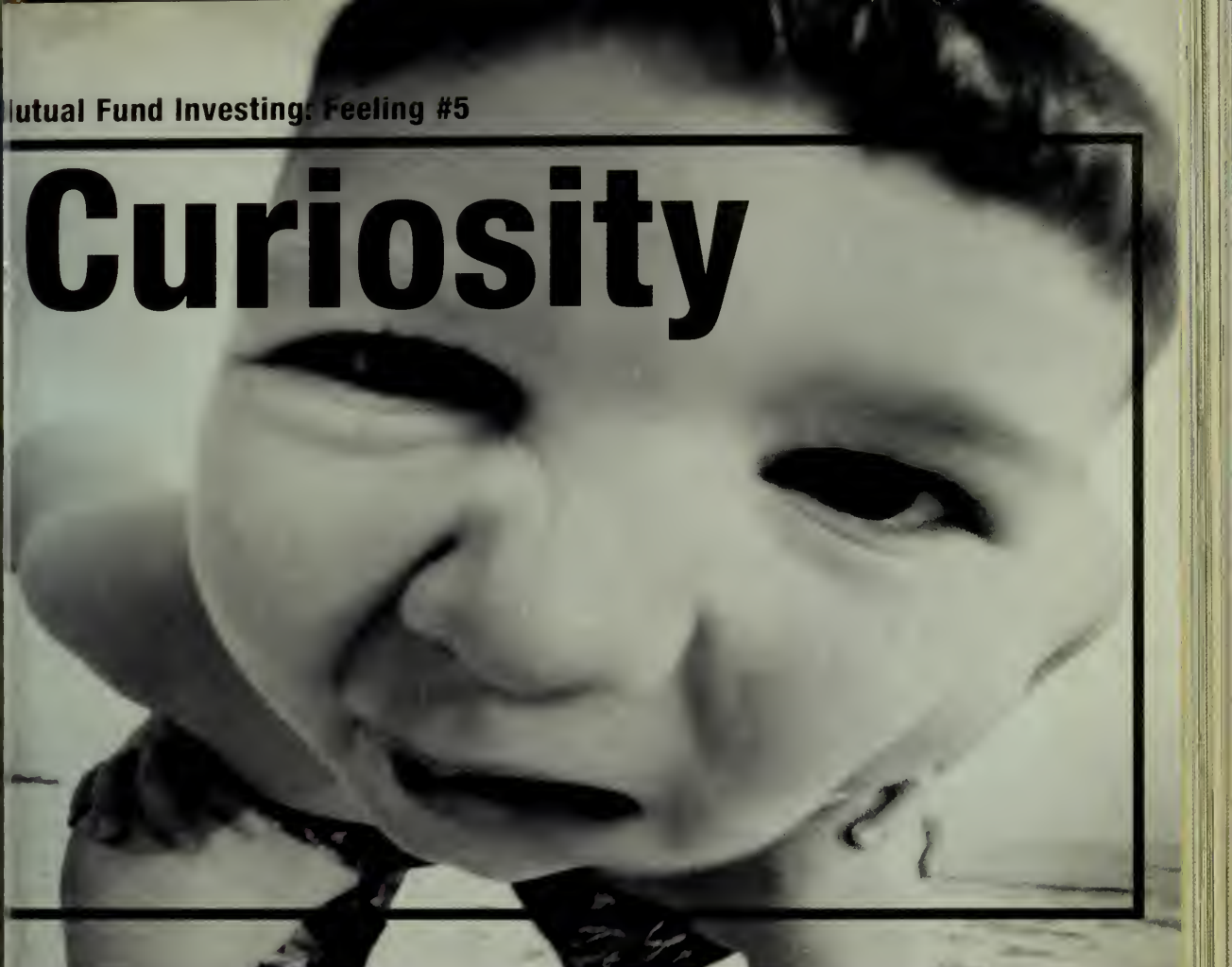
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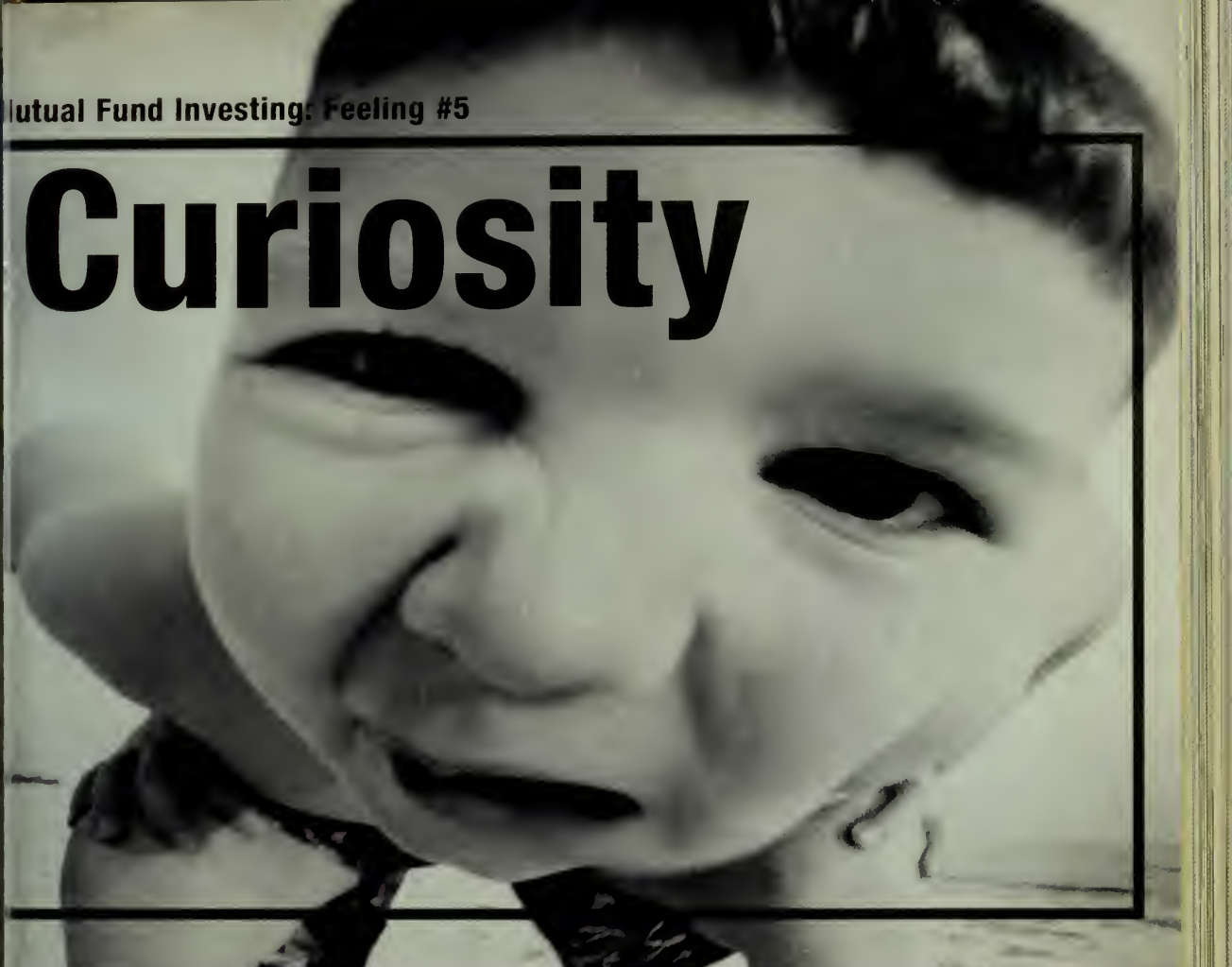
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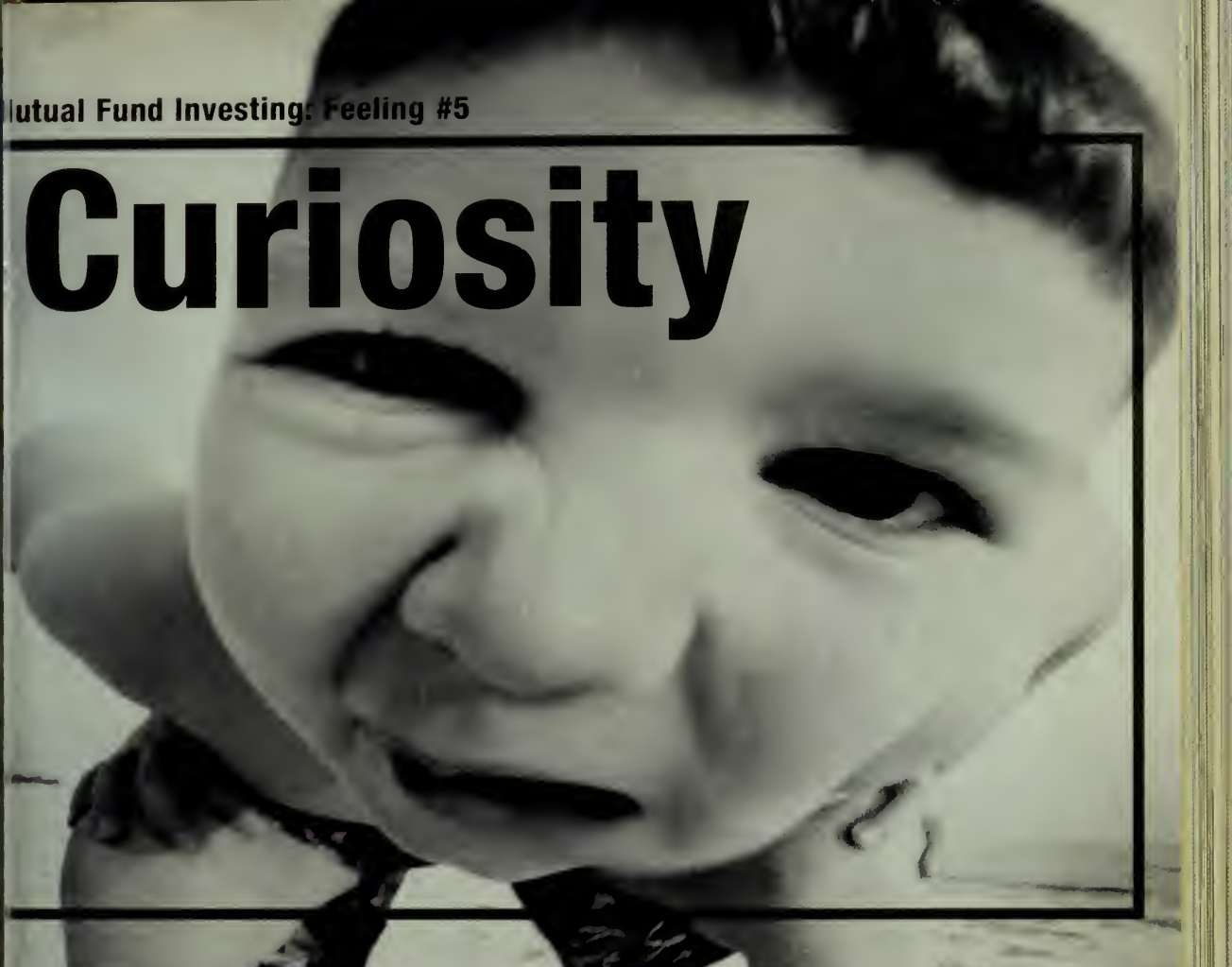
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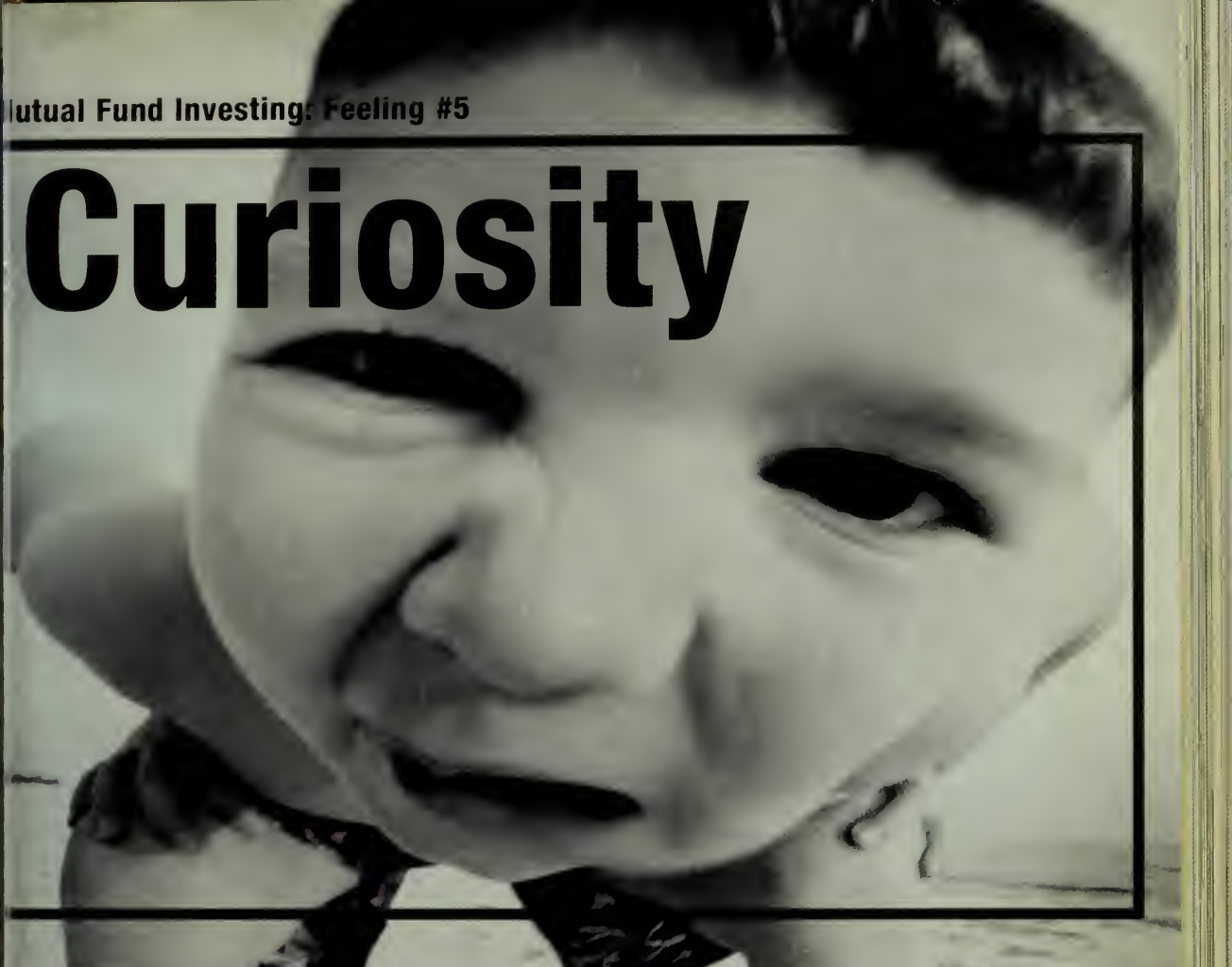
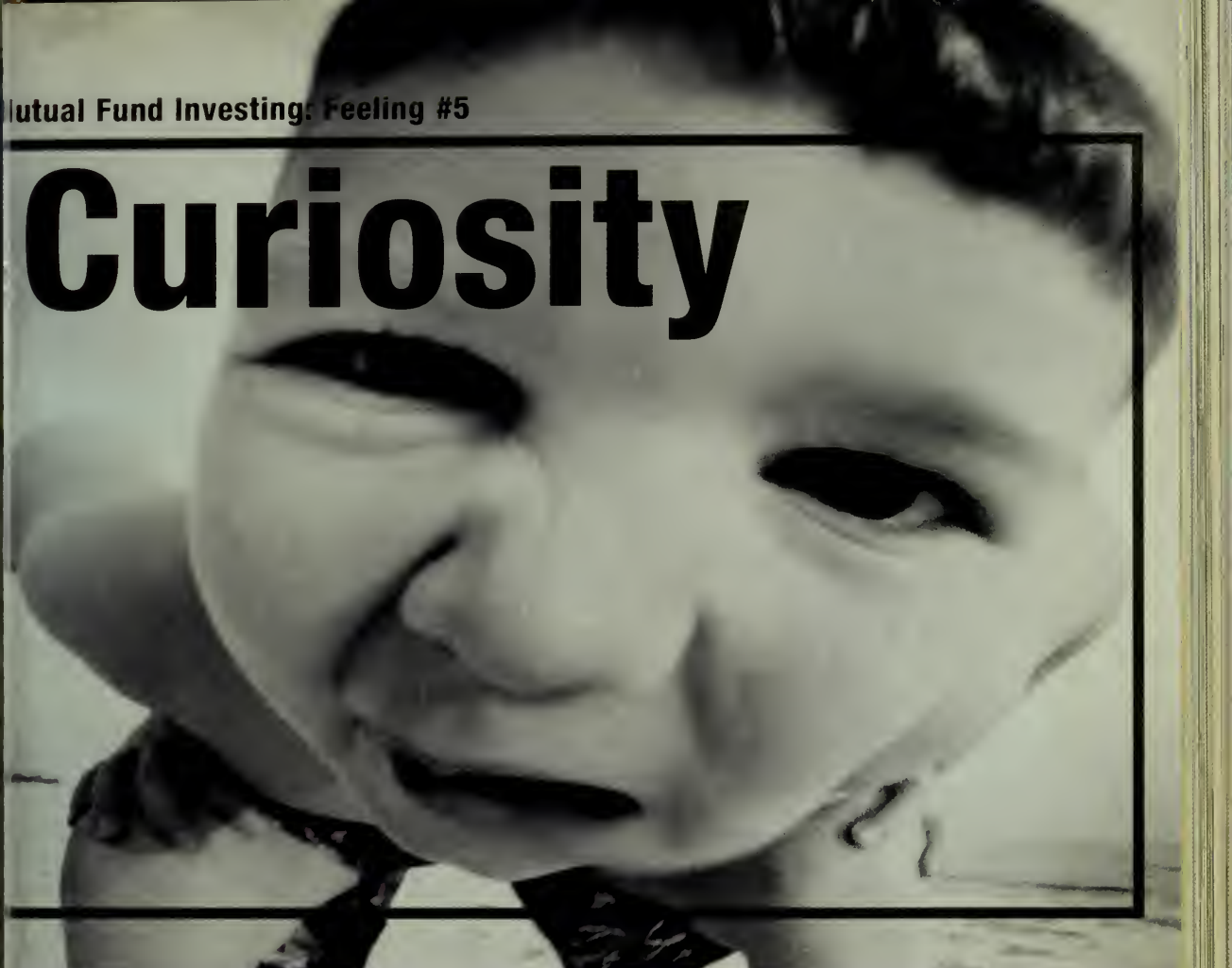
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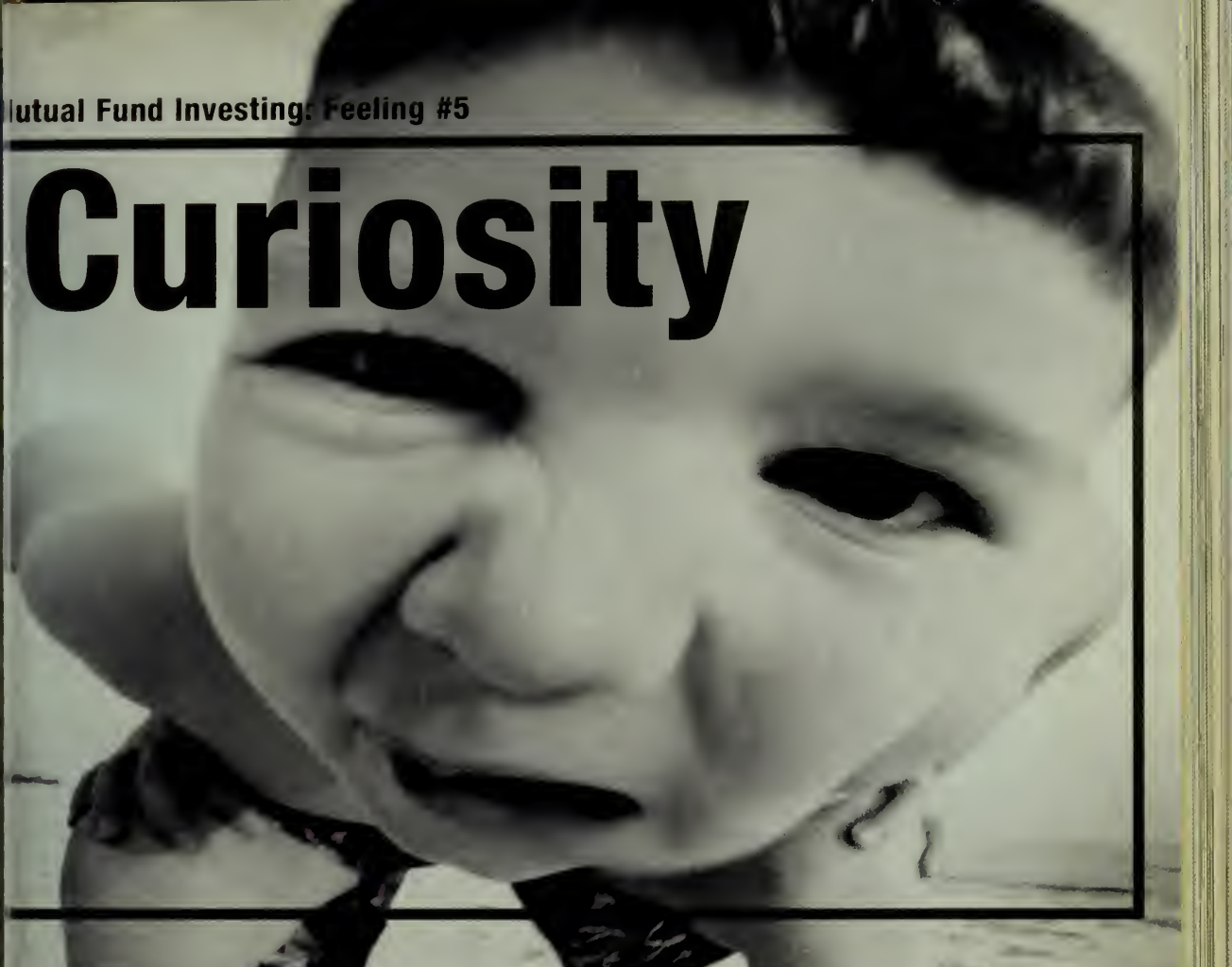
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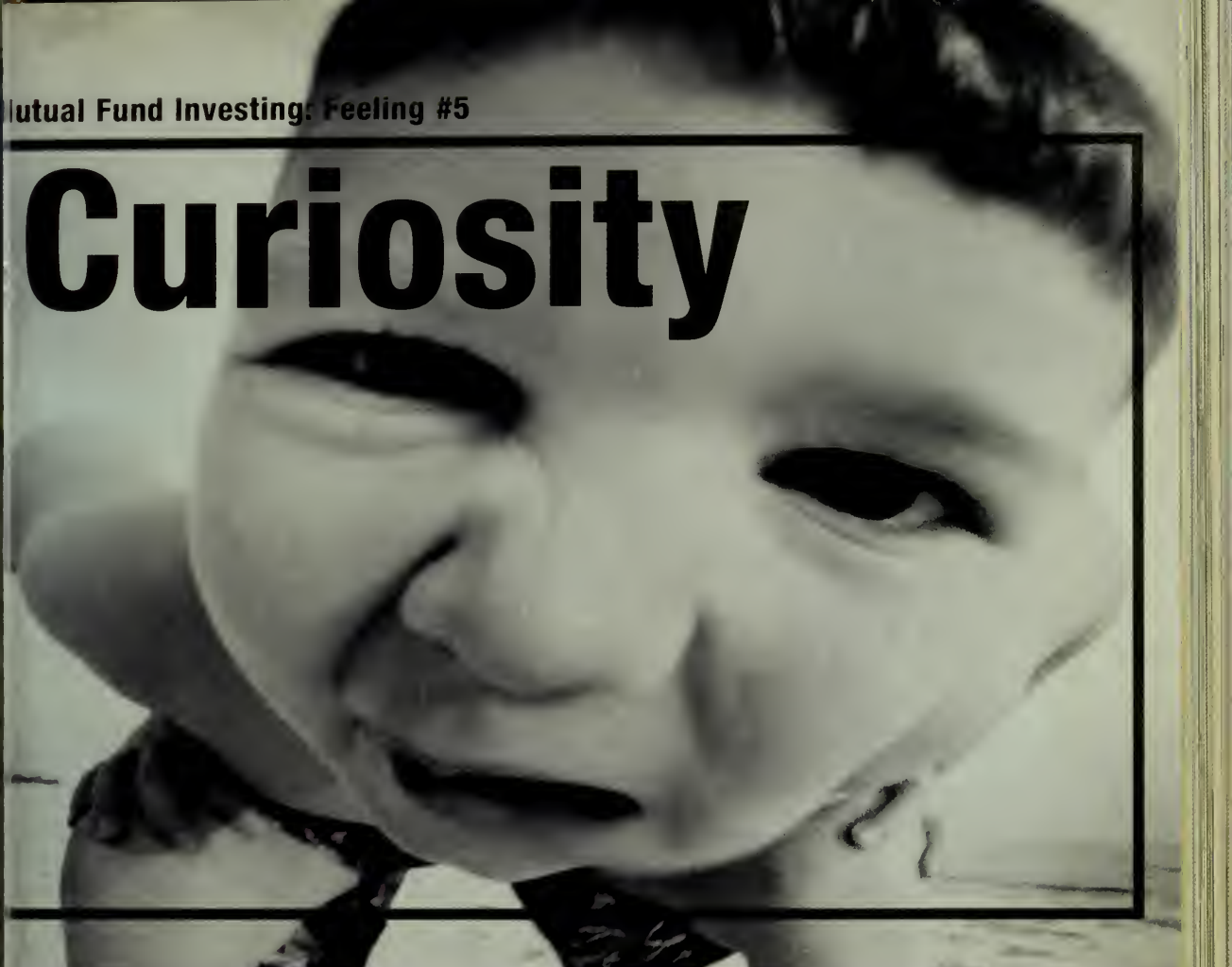
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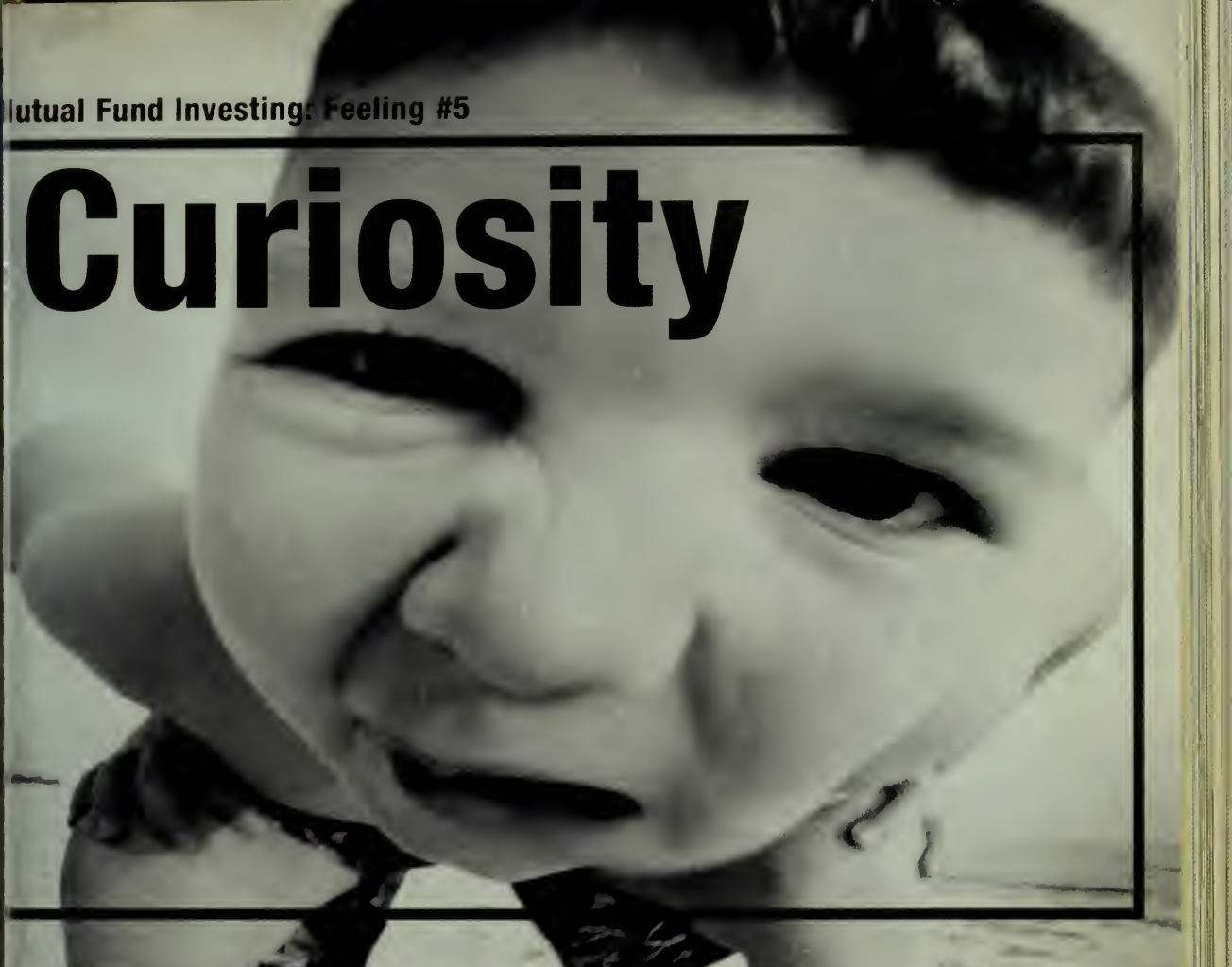
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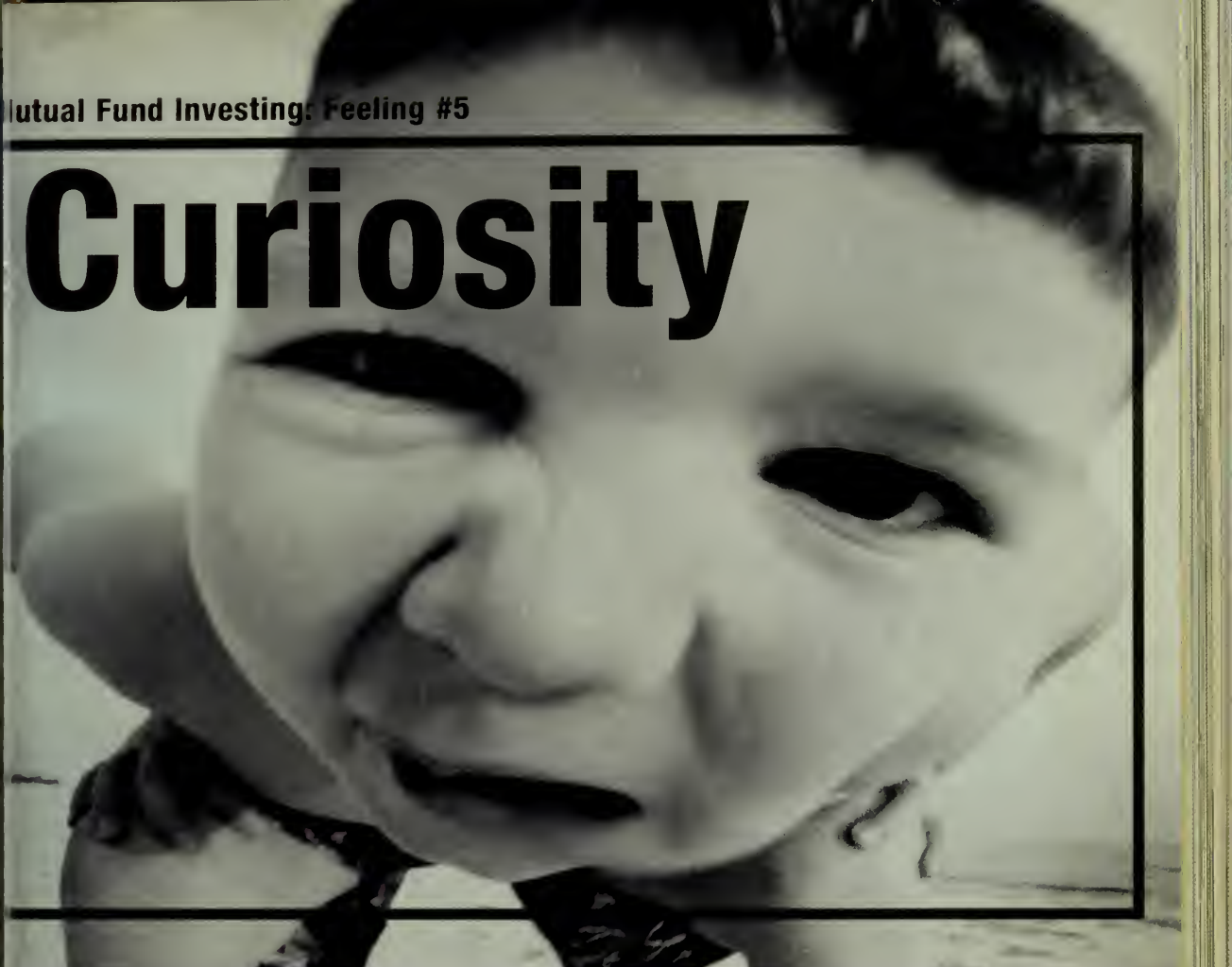
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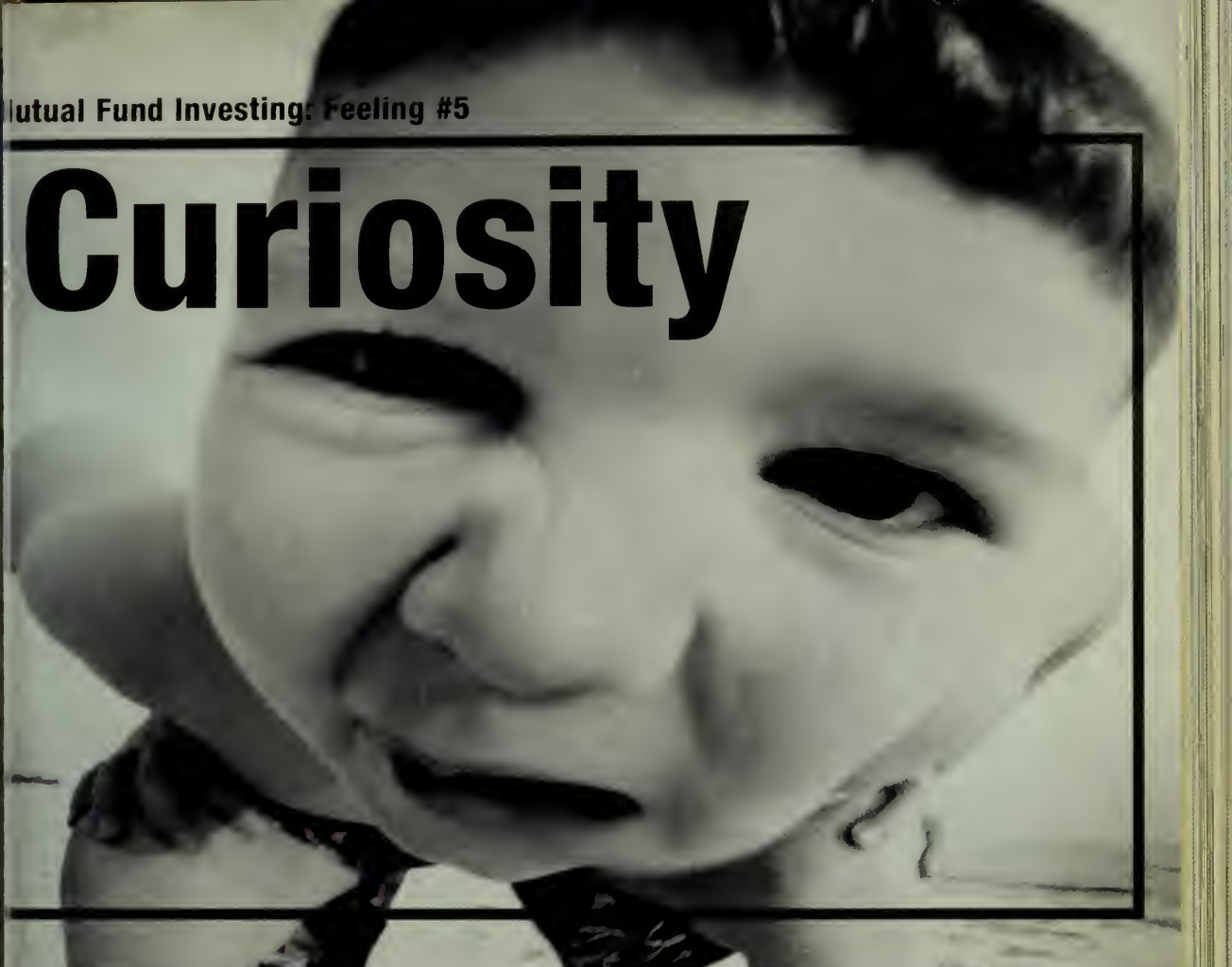
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WHY THE 'THREE AMIGOS' STILL HAVE FRIENDS

The "Three Amigos" did a wonderful job bringing Yahoo! Inc. to where it is today ("Inside Yahoo!" Cover Story, May 21). The concepts underlying its business are still very sound. What is needed is simply a relatively modest adjustment of overall strategy, a somewhat greater adjustment of tactics, and a very major adjustment of its business-development processes.

Yahoo should have sought strategic advice from an appropriate consulting firm at the very first signs of possible problems, rather than struggle through "13 blistering months" that culminated in a totally unnecessary and debilitating top management shake-up.



For all its knotty problems, Yahoo still remains in a far better position to regain and increase its value than many other competing companies that were affected by the deflation of the Internet phenomenon.

Irving I. Goldmacher
 Stony Brook, N.Y.

I'm surprised to hear of Timothy A. Koogle's disengagement at Yahoo. When I signed up for Yahoo Bill Pay! a year ago, I had a problem with it and wrote an e-mail to Koogle. He immediately ordered up a solution, gave me an extra three months' free service, and person-

ally sent a follow-up message after the issue was resolved.

Stephen Clifford
 Beulah, Mich.

MARKET FORCES WILL RING TRUE WITH THE BELL BILLS

"The FCC should crack down on the Bells" (Editorials, May 21) repeats familiar myths about telecommunication competition. Chief among these is the idea that we can regulate ourselves to state of fair and open competition.

The Telecommunications Act of 1996 promised consumers more choices. SBC Communications Inc. and other phone companies opened their networks to new providers of local service. Today 10 million lines in SBC's 13-state area are being served by competitors. The evidence that our markets are open was compelling enough that state and federal regulators have permitted SBC to begin offering long-distance service.

Many would-be competitors survive just long enough to be acquired by larger providers or merely fell victim to their own business plans. In any case they quickly realized there was more profit in "cherry-picking" high-end business customers—thus the low percentage of residence customers cited by *BusinessWeek* as getting local service from non-Bell companies.

In citing "soaring" prices for broadband connections, *BusinessWeek* overlooks the fact that regulation is a major contributor to our cost of providing broadband service. Cable providers pursue their vision of wiring the nation for broadband unbundled by regulation.

We agree that "the rollout of broadband is a national goal of the highest order." All the more reason to allow market forces, rather than misguided or punitive regulation, to dictate the cho-

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A Division of The McGraw-Hill Companies

JUNE 11, 2001 (ISSN 0007-7135) *** 3736
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 Executive, Editorial, Circulation, and Advertising Offices: The McGraw-Hill Companies Building, 1221 Avenue of the Americas, New York, N.Y. 10020. Telephone: 212-512-2000. Telex: Domestic 127063; Int'l. 256017689. U.S. subscription rate: \$54.95 per year; 2 years, \$79.95; 3 years, \$99.95. Single copies/back issues, \$9.95. Call 1-800-285-5867 or email: busweek@mcgraw-hill.com. Subscriber Service: 1-800-455-1200. TDD: 1-800-551-1679.
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Readers Report

CORRECTIONS & CLARIFICATIONS

"Ground wars" (Industries, May 21), about UPS vs. FedEx, requires clarification. The story gave the market-share numbers for delivery of online purchases as 10% for FedEx and 55% for UPS. FedEx says a more accurate measure is a recent study from BizRate.com showing 16% for FedEx and 36% for UPS. The table listing unit costs and profits for the two companies mislabeled the air and ground delivery categories as U.S. The figures were for world-wide operations. Another table said FedEx has 43,500 trucks. FedEx says the total vehicle count, including its long-haul business, is 94,800. And FedEx planes are no longer blue and red but purple and orange. See the letter below.

"Sorry, Steve: Here's why it won't work," (News, Analysis & Commentary, May 21) reported that several Mac-only chains, including The Computer Store, have closed down, citing weak margins. While a single store by that name in Wichita Falls, Tex., did cease retail operations in August, 2000, it is not affiliated with Computer Stores Northwest, Inc., which operates a chain of six stores also called The Computer Store in the Pacific Northwest. Computer Stores Northwest says it has no plans to close any of these stores. *BusinessWeek* regrets the error.

In "The most aggressive CEO" (Management, May 28), J. Brad McGee, executive vice-president of Tyco International, was misidentified as a former U.S. Marine. He is a former U.S. Navy officer.

es available to consumers. Legislation before Congress would speed that process immediately.

Edward E. Whitacre Jr.
Chairman and CEO
SBC Communications Inc.
San Antonio

THE ASCENT OF FEDERAL EXPRESS

Contrary to the conclusion reached in "Ground wars" (Industries, May 21), FedEx is gaining ground on its main rival. Consider this: In 1980, FedEx' revenues were \$415 million; today, they total more than \$20 billion. Put another way, the company has grown from one-tenth the size of UPS in 1980 to more than two-thirds the size of UPS today. So who's really catching up to whom?

Even a cursory review of the numbers would have revealed that FedEx has consistently improved its lead in

the express and ground transportation sectors over UPS in revenue, as this table of yearend market share shows:

	EXPRESS 2000	EXPRESS 1996	GROUND 2000	GROUND 1996
FEDEX	39%	38%	11%	8%
UPS	34%	33%	78%	83%

Source: The Colography Group

FedEx has surpassed the UPS yield growth (revenue per package) in every category—overnight, deferred, ground, and international—in each of the past three comparable quarters.

FedEx has seized growth opportunities no competitor can match, including: the acquisition of American Freightways; the groundbreaking retail/transportation agreements with the U.S. Postal Service; a special home-delivery service for the e-tailing segment, and alliances in fast-growing international markets, such as La Poste in Europe.

Along the way, FedEx has built what is the most seamless global air and ground network in its industry, connecting more than 90% of the world's economic activity. The FedEx network, nearly impossible to replicate, lets the company provide a substantially higher quality of service than its competitors.

Next, can we at last put to rest the issue of the e-mail threat to FedEx overnight envelope market? Express delivery envelopes account for only 9.3% of the company's revenues. Of that, a large percentage is impervious to e-mail because many of these envelopes contain intellectual property or components that cannot be transmitted via the Internet—items such as medical devices, electronics, or personal gifts.

It is distressing that *BusinessWeek* has never given readers a fair opportunity to understand the strategy and performance of FedEx. They have only been exposed to your dismissal of it.

William G. Magaritis
Corporate Vice-President for
Worldwide Communications
& Investor Relations
FedEx Corp.
Memphis

Editor's note: See the Corrections & Clarifications box.

THEIR KIND OF TOWN, CHICAGO IS

One has to assume that the Boeing Co. executives who selected Chicago—over Dallas and Denver—for their new headquarters decided that *BusinessWeek's* obituary for Chicago as a major business center was premature ("Chicago blues," Cover Story, Oct. 16, 2000).

While the reporters said that Chicago was a great, livable city, it was "slipping as a business capital."

Boeing CEO Philip M. Condit said the decision was based "on good, so business reasons." Incentives were no factor, he stated. Of course, in fairness to *BusinessWeek*, its dire prognostication last October was obviously made well before the Boeing decision. Or even before the decision by Ford Motor Co. for an automotive complex in Chicago. Moreover, it was some three months before Chicago's alleged "shrinking" financial markets were deluged with record-breaking transaction volume, which catapulted the Chicago Mercantile Exchange to first place in American derivatives markets.

Leo Melan
Chairman Emeritus at
Senior Policy Advisor
Chicago Mercantile Exchange Inc.
Chicago

Editor's note: Chicago Mayor Richard M. Daley and Illinois Governor George H. Ryan promised at least \$63 million in incentives to Boeing—far more than Denver and Dallas offered. The Ford complex will come at an additional cost to taxpayers of more than \$100 million. While the Boeing move is a coup for Chicago, the head offices of at least two other major companies have been lost to Chicago in the past seven months.

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VILEGED SON

Chandler and the Rise and Fall of the L.A. Times Dynasty

Dennis McDougal
seus • 526pp • \$35

WE BUILT A GREAT PAPER. THEN HE QUIT

The preeminent newspaper dynasties have run their operations differently from most other businesses. Major, even controlling, positions in the stock, members of such families as the Sulzbergers, Grahams, McCormicks have striven to make a respectable return on investment, but their chief goal has been producing superior journalism. Maintaining family control while building publicly traded, widely diversified media corporations is not easy. The stock market is demanding higher profit margins. In particular, the Sulzberger and Graham families, of *New York Times* and *The Washington Post*, respectively, have managed the process successfully.

Then there are the Chandlers, owners of the *Los Angeles Times* until they sold it to Chicago's Tribune Co. in an \$8 billion deal in March, 2000. Their failure is exhaustively detailed in Dennis McDougal's *Privileged Son*, an informative book that suffers from overly dramatic prose and a lack of organization.

McDougal tells two related stories: the emergence of the *Los Angeles Times* as one of the most powerful newspapers in the West and the history of the powerful Chandler family that dominated the West, and Southern California, for much of the last century. The author's depiction of some of the major players is compelling, especially that of Harry Chandler, the newspaper's publisher from 1917 to his death in 1944.

In 1885, the 22-year-old Harry took a loading of copies of the fledgling *Los Angeles Daily Times* on wagons. Nine years later, Chandler married the daughter of the *Times*'s then-publisher, Harrison Gray Otis. Chandler went on to build a huge empire. Real estate was his base: His holdings amounted to more than 1.5 million acres at their peak. But Chandler branched into everything from cotton to shipbuilding to insurance. He

sat on more than 40 boards and held large blocks of several dozen companies' stock. His clout extended deep into politics—mostly far to the right. Critics decried his ruthless, shady tactics. In large part, Chandler was the model for the villain in the 1976 film *Chinatown*, a classic tale of greed and venality.

Harry Chandler was a seminal figure, but it is Otis, his grandson, who dominates *Privileged Son*. Named publisher in 1959 when he was only 31, Otis transformed the *Times* from a profitable but miserable right-wing rag to one that was a worthy rival to *The New York Times*. Under him, the paper won 21 Pulitzer Prizes. Circulation and profits soared. To outsiders, Otis seemed destined for a long reign.

But Otis saw things differently. Even as he was reshaping the *Times*, he was building another life as an adventurer—a life that gradually displaced publishing. The Chandlers were methodical and relentless, but Otis took after his grandmother's side of the family, which was restless and risk-taking. He hunted big game in Alaska, surfed, and competed in car races. By 1980, he had rescued and re-created the newspaper beyond all expectations. It was time to re-create himself. He stepped down as publisher. Said one *Times* editor: "Otis is going surfing, and he's never coming back."

Rather than encourage his children to enter the business, Otis seemed to sabotage them. He stated publicly that his two eldest sons would not make good publishers. Said third son Michael: "My father's got an ego.... It was probably his ego that contributed to his attitude toward keeping us kids from carrying on. He wanted to go down in history as the last of the great Chandlers."

McDougal, a former *Los Angeles Times* writer, takes no position on the journalistic potential of any of Otis' sons or their cousins. But as his account vividly shows, from the time Otis quit, it was all downhill. In 1986, *Times Mirror Co.*'s board forced the distracted Otis to relinquish his post as chairman, leaving him with the empty title of chairman of the executive committee. He didn't fight the demotion, though Otis and his cousins, through trusts, controlled the company.

By 1989, a new wave of editors, advocates of a more breezy approach to journalism, came aboard. In the vanguard were Shelby Coffee III, from *The Washington Post*'s Style page, who became editor, and David Laventhol, the publisher of *Newsday* (owned by *Times Mirror*), who became publisher. They pushed a faster format and what the author calls "exclamation point journalism." Controversy was soft-pedaled.

Then, in 1995, Mark H. Willes, former vice-chairman of General Mills Inc., took

over as CEO. He abolished the wall between advertising and editorial: "I'll use a bazooka if necessary," he said. Possibly sensing vulnerability at *Times Mirror*, executives at Tribune Co. arranged a takeover. Tribune CEO and Chairman John W. Madigan has a Wall Street background, is a fierce cost-cutter, and boasts a 29.2% profit margin, higher than any other newspaper company.

It's questionable whether exceptional journalistic standards will prevail in the face of the relentless push for profits.

McDougal has pulled together a wealth of information. Unfortunately, his material seems only semidigested. One yearns for broader coherence, a clearer sense of narrative. Also, McDougal's prose is riddled with clichés.

For all that, *Privileged Son* sounds a warning that family-owned media companies, even with huge assets, are fragile. It's too bad, since when they take a stand, such papers, along with journalism schools, can be a defense against the dumbing-down, by-the-numbers approach so pervasive in the media today.

BY CHRIS WELLES

Former *BusinessWeek* editor Welles worked at the *Los Angeles Times* from 1983 to 1985.



THE L.A. TIMES SUFFERED AFTER OTIS CHANDLER STEPPED DOWN TO PURSUE ADVENTURE



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THE NATURE OF WHAT'S TO COME™

BY STEPHEN H. WILDSTROM

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A ROAD TEST OF TRAVELING LAPTOPS



Wherein I try two PC cards, two machines, two networks. Guess what? Nothing's perfect

When using wireless handheld computers, I have come to regard flaky connections and slow network downloads as normal. But working with a wireless laptop somehow creates a different level of expectation; what seems acceptable on a Palm or Pocket PC becomes frustrating on a notebook.

With that mind-set, I tested a couple of PC Cards, which serve as wireless modems for laptops. Compaq Computer is selling its new, ultra-light Presario 800 bundled with a Novatel Merlin card that allows it to run on the Ricochet network. Sprint PCS offers a Sierra Wireless AirCard 510 that uses Sprint's digital wireless phone network. Both add a new dimension to a laptop—and both suffer from serious limitations.

Metricom's Ricochet service (www.ricochet.com) has been around for several years but has relied on bulky external modems that limited its usefulness. Now, the only sign of the modem is an awkward antenna that gets in the way when the notebook is closed. Windows treats the card like a modem on a dial-up network. Ricochet offers speeds of up to 128 kilobits per second in 13 markets, including New York, Los Angeles, and Houston, with older networks providing 28.8 kbps in Washington and Seattle.

The Merlin card and 3.5-pound Presario 800 make a good mobile combo, especially when the \$1,699 laptop is equipped with an optional extended-life battery. The standard battery life of under two hours is too short for serious mobile use. Compaq offers Merlin (which can also be used in an iPAQ Pocket PC) for \$300, plus \$74.95 a month for unlimited service. Similar prices are available from other Ricochet resellers.

Ricochet presents two drawbacks. One is limited geographic coverage. It won't work unless you live in a Ricochet city and even then may be useless when you travel. Worse, Metricom, which has been forced to make major cutbacks in its network expansion plans, warned in a May Securities & Exchange Commission filing that it could run out of cash as early as August. That would be a huge blow to the growth of wireless data services, because in those places that it works, it's the best service out there.

There's not much fear that Sprint PCS (www.sprintpcs.com/wireless/), which offers service in most urban areas across the U.S., is go-

ing away. But what it gains in ubiquity, it loses in performance. The Sprint network is set up to move data at just 14.4 kbps, typical of wireless services. The actual speed is significantly slower especially when the signal is weak.

I tried Sprint using a Sierra Wireless AirCard 501. The card runs around \$400, and the cost of service varies with service plans. For \$74.99, you get a total of 2,000 minutes, with free long-distance for your phone or your laptop. In addition to inherently slow speeds, the service displays the vagaries of wireless phones: Sometimes a connection is nearly instantaneous; sometimes it takes up to a minute. Calls fail and connections break off in mid-session for no apparent reason. But if you need mobile Internet access on a laptop, the Sprint service is a lot better than nothing. I managed to use it to fetch mail while on a New York-Washington train.

DISCRETION. E-mail is the critical application for mobile wireless, and software companies, especially Microsoft, could improve matters by offering mail programs tailored to mobile needs. Standard programs, such as Microsoft Outlook and Outlook Express, assume stable, relatively fast connections. It would be useful if these programs had a mode that emulated the sort of e-mail people use on Pocket PCs and other handhelds. For example, it would help if the program



RICOCHE EFFECT

The Presario 8000's new card is speedy in a few cities, but its carrier may not be able to expand

only downloaded the header and first 500 characters or so of each message, then offered the choice of getting the rest of the message or any attachments. That way we could scan all messages, retrieving only the important ones in full.

Meanwhile, wireless phone networks are slowly getting better as a result of consolidation and new technologies. In next week's column, I'll take a look at these changes and what they mean for voice and data service. The improvements are probably worth waiting for, but if you need service now, you'll have to make a tough choice between performance and coverage.

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BY ROBERT J. BARRO

A 'YANKEE IMPERIALIST' OFFERS ASIA A ROAD MAP



REVIVAL:
Countries hard-hit by crisis could strengthen their banks by allowing foreign ownership. South Korea should consider dollarization

Before the 1997 financial crisis, the fast-growing economies of East Asia were favorites of economists and international investors. Then Indonesia, Malaysia, South Korea, and Thailand were hit hard with currency devaluations and high interest rates. A 40-year period of sustained rapid growth was replaced in 1998 by sharp economic contractions in these countries, ranging from 7% in South Korea to 15% in Indonesia. What has happened since? Are the subsequent reforms and economic recoveries strong enough that investors should rush back into these four crisis countries?

In terms of economic growth, the recovery has been impressive in South Korea, with growth averaging 9% a year for 1999-2000. The rate has slipped recently. Reasonable recoveries occurred in Malaysia and Thailand. Indonesia has yet to grow much at all.

Other signs are much less favorable. In the past, the four crisis countries had been known for high rates of saving and investment. In 1997, ratios of investment to gross domestic product ranged from 30% to over 40%. These values collapsed by 10 to 15 percentage points during the financial crisis and have yet to rebound much. Although the earlier levels of investment were excessive, the failure of investment to recover suggests that businesses do not anticipate returns to the sustained high growth of the past.

This impression is reinforced by stock-market prices, which have yet to gain their 1996 levels in U.S. dollar values. Thus, the stock markets also point toward lower growth. The obvious comparison is with Japan at the end of the 1980s, where the collapse in stock prices accurately signaled more than a decade of subsequent growth at anemic levels.

At a recent conference I attended in South Korea, economists from the International Monetary Fund and elsewhere discussed possible policy changes that might improve the economic outlook. My suggestions led some participants to label me a "Yankee imperialist," although I naturally regarded this characterization as unfair.

My first ideas were about the banking sector. Although economically important, this sector has been a recurring source of problems for many middle-income countries. In South Korea, the banks are predominantly government-owned and -run, a situation that does not look promising for the efficient allocation of credit and the promotion of growth. The government has been dragging its heels on privatizing the banks, especially with regard to sales to foreigners. This

policy is a mistake, because foreign ownership of banks offers a number of advantages to a middle income country.

First, a foreign company with strong capitalization could withstand the disturbances that in the past have led to bank failures. Second, the government would have limited ability to pressure a foreign-owned bank to lend money to favored sectors, such as the large business groups (*chaebol*) in South Korea. This immunity to pressure is favorable for the economy but may explain the reluctance of many governments to encourage foreign ownership. Finally, the government would not be inclined to bailout a foreign-owned institution; knowing this, the institution would have to be prudent in its lending practices.

In such matters, Asian countries could learn from Mexico. With Citibank's purchase of Banamex and the buyout of two other institutions by Spanish companies, the three largest Mexican banks will now be run by strong foreign institutions. Because of these changes, Mexico's banking sector finally looks promising.

CLOSE TIES. Another issue in South Korea is the too-big-to-fail doctrine, which had been applied in the past to the *chaebol*. More recently, the government has been willing to allow the market to decide which businesses will survive, as was clear with the failure of Daewoo. However, the policy will soon be tested again, as the government seems tempted to intervene with troubled parts of Hyundai.

Finally, I suggested that South Korea consider relinquishing its own currency and adopting the U.S. dollar. Dollarization would avoid the kind of currency crisis that occurred in 1997-1998. Although South Korea would have to abandon an independent monetary policy, such independence has always been a mixed blessing. Moreover, unlike Argentina, which has recently had problems with its currency board because of the strong U.S. dollar, South Korea is linked fairly closely to the U.S. in trade and other dimensions. Another favorable element is that dollarization could be combined with negotiations for freer trade with the U.S.

My proposal for dollarization, combined with my endorsement of foreign buyouts of banks, led to the Yankee-imperialism charge. However, the more serious issue is whether I am correct that these policy changes would improve the economic outlook and encourage the return of investor enthusiasm. My fallback position is that Yankee imperialism is the best type of imperialism.

Robert J. Barro is a professor of economics at Harvard University and a senior fellow of the Hoover Institution (rjbweek@harvard.edu).

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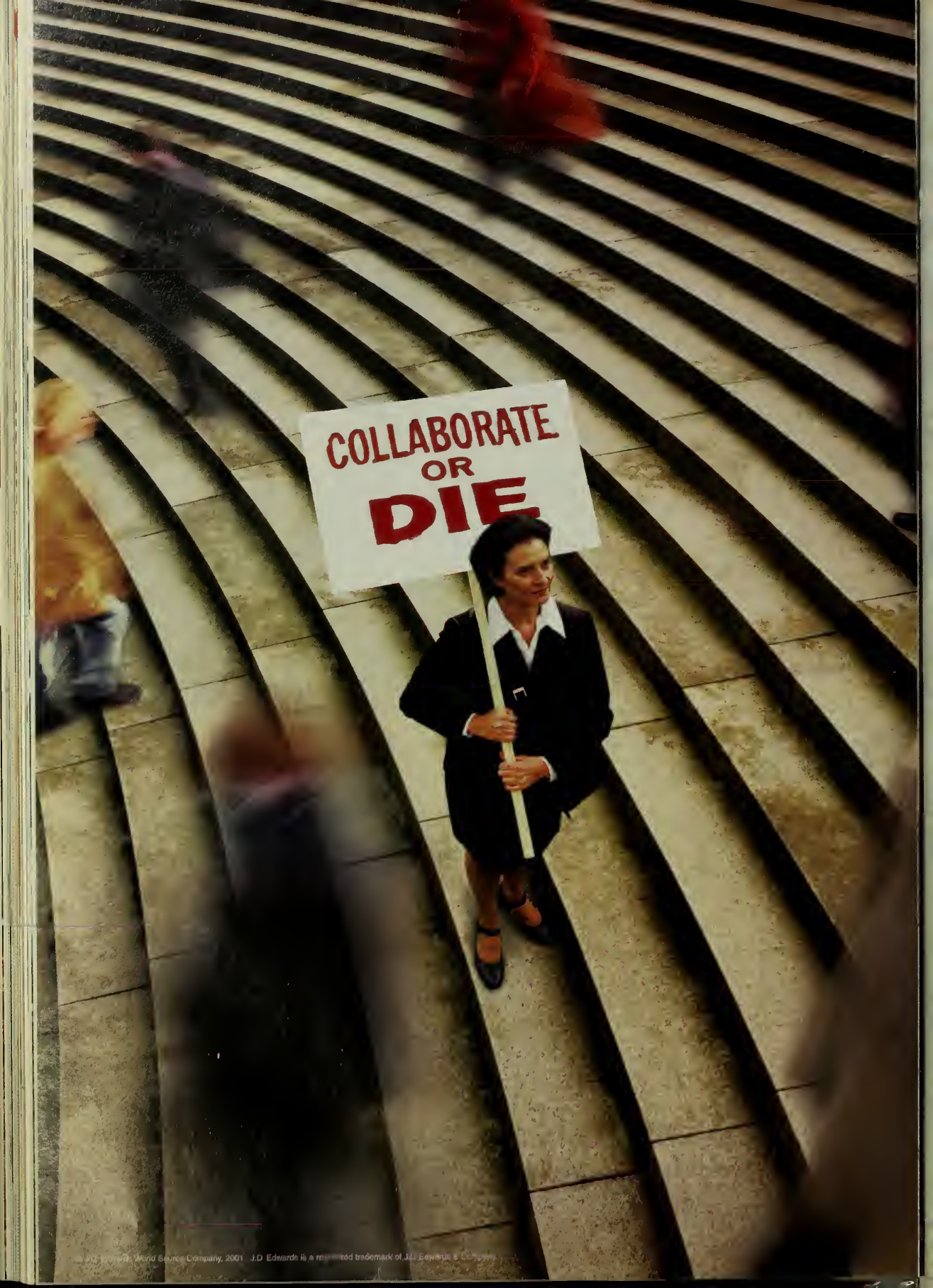
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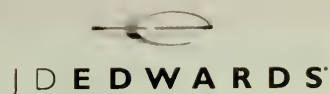
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BY GENE KORETZ

WHY AMERICANS WORK SO HARD

How pay inequality galvanizes effort

Observers have long remarked on the sharp disparity between American and European work habits. Americans not only put in considerably more time on the job, but their yearly tally of work hours has actually risen in recent decades. In contrast, most Europeans work fewer hours and have enjoyed a steady decline in annual work time.

A common view is that this differ-

TWO CULTURES, TWO TRENDS IN WORKING HOURS



ence reflects cultural factors: Europeans, who tend to regard Americans as workaholics, simply prefer leisure to labor. Surveys indicate, for example, that many Europeans would like to reduce their work time, while many more Americans would like to increase theirs and earn more despite the fact that they already clock a lot more hours.

In a recent National Bureau of Economic Research study, however, economists Linda A. Bell and Richard B. Freeman suggest that the difference is related less to cultural values than to the wider range of wages within U.S. companies and the overall economy. In essence, they argue that America's greater pay disparity creates incentives for employees to work harder.

As evidence, the authors cite data on German and U.S. labor markets and workers' attitudes. In both countries, they note, workers in occupations with greater wage inequality tend to put in longer hours at work. But in America, where such inequality is more pervasive, they report that a much larger percentage of workers believes that their chances for advancement are high and that their work effort will pay off in pay hikes and promotions.

The authors' analysis of German and U.S. workers' histories bears this out. Although they find a strong link between past hours worked and current wages in both countries, the effect is far more substantial in the U.S. They estimate that an American who boosts his working time by 10%, from 2,000 to 2,200 hours a year, tends to raise his future earnings by about 1% for each year that he puts in extra hours.

In sum, workers in both nations appear to log more time on the job when pay scales are unequal, but the impact is much weaker in Germany, where wages are far less variable and where greater job security, high jobless benefits, and a national health system cushion the adverse effects of layoffs. Americans work longer hours mainly because of the lure of big wage gains, the authors suggest, they're also responding to the higher risk of losing income and health coverage if the boss lets them go.

Are German or American workers better off? Pointing to the U.S. economy, many economists argue that wider pay scales lead to greater work effort that produces rising productivity and higher levels of income for all workers. On the other hand, surveys indicate that many Americans are ambivalent about their long work hours. While they are reluctant to give up the chance to enhance their incomes, they would prefer to spend more time with their families.

If the authors are right, European nations will have to give up their preference for relatively low work hours if they want to achieve American-style wage disparity and growth. And Americans who want to reduce their workaholic behavior will find it difficult unless pay inequality also starts to narrow.

THOSE WITH THE GUTS TO SAY 'SELL'

Which analysts go out on a limb

If you're worried about a stock you're holding, it might pay to check the views of both the most prominent and least prominent analysts who follow it. So implies a study by Ezra Zuckerman of Stanford University and Damon Phillips of the University of Chicago.

The two B-school professors recently compared the rankings of a sample of stock analysts with their stock forecasts in the mid-1990s. They found that fewer than 5% of all the forecasts issued involved explicit sell recommendations, and no less than 85% of the analysts

gave only positive or neutral opinions.

By itself, this finding is hardly surprising. Past studies have shown that most analysts are loath to issue sell opinions, often choosing instead either change a stock's status to "hold" or quietly drop it from coverage.

What's intriguing about the Zuckerman and Phillips study is the identity of the intrepid analysts who advised investors to sell. As it turned out, those who were willing to blow the whistle tended to be either the most prestigious or the lowest-ranked analysts.

This pattern, the authors note, is in line with a sociological theory that conformity is weakest at the top and bottom of a "status" hierarchy. In other words, top analysts feel secure enough to deviate from conventional behavior without jeopardizing their status, while low-status analysts feel free to do likewise because they have little to lose.

WHERE CLOUDS AREN'T BREAKING

Tech execs are getting gloomier

While consumers and small-business owners seem more optimistic about the economy recently, technology business leaders are getting more anxious. According to PricewaterhouseCoopers' latest quarterly survey of tech executives, completed in March, nearly half are uncertain about the outlook and more than a fifth are downright pessimistic.

The upshot: Technology companies are scaling back hiring plans, with over 56% planning to add workers over the next year (vs. 77% in the prior quarter) and 16% planning job cuts. And though revenue growth at just 16% over the next year, down from the previous reading of 23.5%.

On the positive side, some 50% of companies still plan to make major capital investments in the next year. A majority will be investing in both information technology and new-product development, but the number planning to put more cash into e-commerce has declined by half, to just 32% over the past 12 months.

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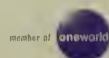
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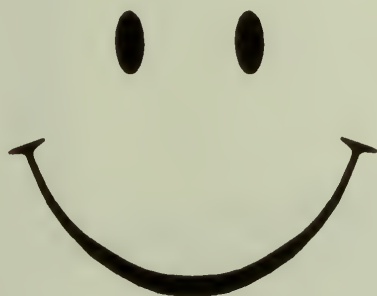
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TAX MONEY WILL SOOTHE THE SECOND HALF

But second-quarter GDP growth may be the worst since the last recession

U.S. ECONOMY

Sometimes good economic policy is like profitable investing:

nothing is everything.

Although the data are still sketchy, there's a growing chance that the second quarter's real gross domestic product could be shrinking, leading to accelerating job losses and pronouncements of recession. But just as these ominous tidings begin to lead the evening news, in this summer, tax rebate checks will start to show up in mailboxes, and the Federal Reserve's superaggressive rate cuts will hit. Right now, the second-half outlook hinges on the crucial idea that this double dose of government stimulus will more than offset the drags currently holding back the economy.

TECH INVENTORIES ARE STILL EXCESSIVE

INVENTORY-SALES RATIO FOR COMPUTERS AND RELATED PRODUCTS



Inventory will be the chief weakness in second-quarter GDP, falling even faster than it did in the first quarter. The problems in the tech sector were one reason Fed Chairman Alan Greenspan warned in his May 24 speech that "the period of subpar growth is not yet over."

Also clouding the second quarter: Many GDP components that added at least moderately to growth in the first quarter are not providing the same cushion again. For example, housing is flattening out, the trade deficit is unlikely to repeat its sharp first-quarter narrowing, and consumer spending is growing at about half of the first quarter's 2.9% pace. Add it all up, and the second quarter will very likely be the weakest since the 1990 recession. After that, will the economy be able to shake itself?

AT THAT SCORE, the outlook is hopeful. First, the liquidation of excessive inventories in the first quarter turned out to be even greater than first reported. The Commerce Dept.'s revised GDP data show growth at 1% instead of 2%, mainly reflecting an \$18.9 billion drop in inventories. That drawdown helps to clear the

way for future production. Second, despite dismal job news, consumers have not cut back on their spending and actually showed increased confidence in May.

Finally, the biggest lift to growth will come from the rapid and aggressive actions of the Fed and the unusually fortuitous timing of the Bush Administration's tax plan. Over the next year, tax cuts alone will total about \$100 billion, or about one percentage point added to GDP growth.

The impact will be especially profound in the third quarter, when some \$40 billion in rebate checks, along with about a \$15 billion cut in taxes withheld from paychecks, hit consumers' wallets.

If shoppers were to spend anywhere from half to all of the money in that quarter, it would add between 1.6 and 3.6 percentage points to the annualized growth rate of that quarter's real consumer spending, assuming 2% inflation. Realistically, because of lags, the spending impact will stretch into the fourth quarter. That means the back-to-school shopping season, as well as the important holiday season, will benefit handsomely.

THE TAX CHECKS should fortify the consumer sector, which has remained resilient during these sluggish times. In April, real consumer spending edged up a modest 0.2%. And in May, the Conference Board's index of consumer confidence rose. After plunging from October to February, the index seems to have stabilized at a level far above those usually associated with recessions (chart).

The May results show that while households are concerned about the current job situation, their feelings about future job prospects are a shade more optimistic. Overall expectations for the six months have turned up. June confidence seems likely to register another increase in the wake of the favorable tax-cut details.

Consumer spending and the job outlook will be critical to economic activity in the third quarter. But that outcome depends increasingly on what happens in the corporate sector, as consumers react to businesses slashing labor costs and capital spending in an effort to repair their dismal profits picture.

In its first-quarter GDP revision, Commerce also re-

CONFIDENCE STABILIZES AS EXPECTATIONS RISE



Data: Conference Board

ported on profits economywide. No surprises there. Corporate earnings, adjusted for seasonality and for Commerce's concept of depreciation and inventory values, fell from the previous quarter for the second quarter in a row. Earnings of nonfinancial companies dropped for the third consecutive quarter.

More important, profit margins, measured as profits per unit of output among nonfinancial corporations, are under severe pressure. In addition to the squeeze from higher energy prices, rising labor costs are taking a toll (chart). For example, since the second quarter of last year, when margins peaked, unit labor costs at nonfarm businesses have risen more than twice as fast as prices. For nonfinancial corporations, the disparity has been even greater.

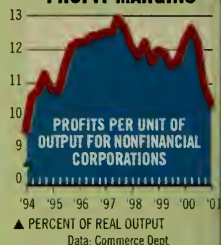
THE LACK OF CASH FLOW, along with reduced expectations for future demand, is cutting into capital spending. April orders for nondefense capital goods plunged 5.2% from March, starting second-quarter bookings far below their first-quarter level. Moreover, April shipments of capital equipment dropped 4.7%, suggesting a sharp contraction in equipment spending in the second-quarter GDP data. Equipment demand is especially weak in the tech sector, where April shipments of computer and related products fell 5.1%, the fourth monthly decline in a row, and April new orders plunged 8.8%.

This weakness is causing the serious backup in inventories of tech equipment. So far this year, tech inventories have barely grown, but shipments have plunged more than 15%. As a result, the ratio of inventories to sales has skyrocketed, especially in relation to the downward trend in that relationship over the past decade. This implies that the current level of stockpiles is far from optimal, and that further production cutbacks in the tech sector will drag down total industrial orders and output in coming months.

Businesses will also be under pressure to cut their labor costs. So far this year, healthy pay growth has supported consumer spending. But layoffs are rising, and companies are trying to hold the line on wage gains.

The outlook boils down to a tug-of-war between Corporate and Household America. Which one will ultimately determine the path of the economy? Households won Round 1, but in the second quarter, the negative impacts from business cutbacks are swaying the balance. However, strong policy stimulus will end up benefiting both sides in the second half. And heading into 2002, consumers and businesses will be propelling the economy forward.

RISING COSTS SQUEEZE PROFIT MARGINS



GERMANY

A WEAK START—AND NO PICKUP UNTIL YEAREND

This time last year, Germany led the euro zone, growing more than a percentage point faster than the area's overall pace. U.S.-led global growth fueled its export machine, while low inflation and improving labor markets boosted consumer spending.

Now, all that has been turned on its head, and economists are yet again dialing down their 2001 growth forecasts, from about 2% into the 1.5% to 2% range, with little hope for a meaningful pickup until yearend.

The latest disappointment was first-quarter real gross domestic product, which grew 0.4% from the fourth quarter, when real GDP grew only 0.2% from the third

quarter, the weakest showing in a year and a half. First-quarter GDP was much softer than it looked. A larger trade surplus contributed about a percentage point to overall growth, but that's because imports dropped sharply, reflecting weak domestic demand. Exports fell for the first time in two years, private consumption went nowhere for the third quarter in a row, and construction investment plunged.

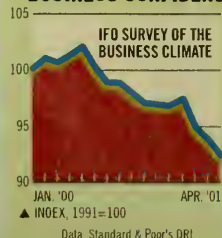
Second-quarter GDP may be flat—or even down. Industrial production had been holding up on the strength of past orders, but March bookings fell off sharply, especially for foreign orders. March output dove, and business sentiment continued

to fall in April to a two-year low.

Consumer spending is getting hammered as higher prices for energy and food hurt household buying power at a time when job growth has come to a standstill. Preliminary May reports place inflation at 3.6%, up from 2.9% in April and from 1.4% a year ago. That's why income and corporate tax cuts totaling 45 billion marks (\$20.2 billion) this year are having no visible impact.

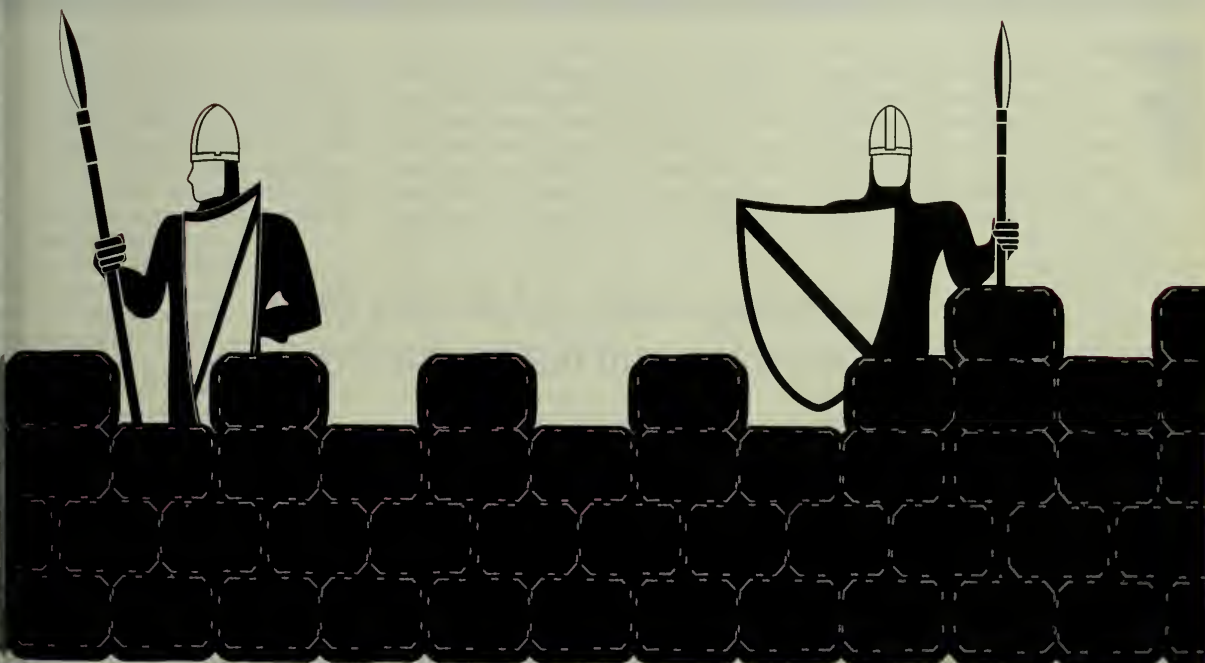
As food and energy prices begin to ease this summer, consumer outlays should pick up. Consumer confidence actually rose in April. However, the export-led industrial weakness will get worse before it gets better. And any further stimulus from the European Central Bank expected this summer will come too little and too late to spur growth in 2001.

A SHARP DECLINE IN BUSINESS CONFIDENCE



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ERNST & YOUNG

FROM THOUGHT TO FINISH.™



For Evan Petrie, the misery began in April, 2000. The 27-year-old computer programmer at Tribune Interactive ordered faster Internet service for his apartment on the northwest side of Chicago. But he soon discovered the wiring inside the 70-year-old walkup wasn't up to the task. It eventually took three visits over six months from the local phone company and his new Net-service provider, Telocity, to get the work finished—and before it was done,

Petrie was forced to pay more than \$100 for a second phone line he didn't need. "I was angry and frustrated—and I don't even really know who to blame," he says.

Maybe someday, broadband will live up to its billing as one of the great technological breakthroughs of our times. But for now, at least, there are dispirited Evan Petries all across the country. And they're all wondering what went wrong with the fledgling broadband market and what it was supposed to have spawned by now—everything from interactive sports programming on TV to DVD-quality movies on demand.

It hardly helps that phone and cable operators widely advertised—some would say hyped—broadband services they can't deliver. And to add insult to injury, after helping to chase smaller new entrants out of the market over the past six months, many of the Baby Bells that provide digital subscriber

to surf the Web do so with a DSL line cable modem. Those that are able to sign up often have to suffer through time-consuming hurdles and headaches before they get their speedier Internet connection—and then, often put up with spotty service when it comes.

This isn't the way the broadband revolution was supposed to play out. By now, 1 million phone lines were to have been installed in up to 1 million homes, based on expectations raised in the pace of orders several years ago. Instead,

there are only 2 million. Indeed, only a fraction of the 35% of U.S. households that have access to DSL and the 5% that have access to cable modems have signed up, according to market researcher Yankee Group.

The news isn't all bad. Overall broadband subscriptions should double this year, to 11 million, according to Tod Cobb, a telecom analyst with J.P. Morgan Case. Still, the headaches persist. The latest stem from the spate of service interruptions linked to the risk bankruptcy rate of DSL carriers such as Northpoint Communications and H

Consumers want it, but they face long waits and big headaches

lines (DSL)—together with the local cable monopolies that offer high-speed cable modems—are hiking prices rather than cutting them to spur a mass market.

The sad part is that while many consumers and small businesses—fed to some degree by overinflated claims—want broadband badly, for a myriad of technical and financial reasons, phone and cable companies have failed miserably to deliver. Five years after the Telecom Act was supposed to unleash a host of new communications services, the digital revolution is still stuck in low gear. Only 6% of households wired

BROADBAND: WHAT HAPPENED?



tine Heckart, president of TeleChoice Inc., a network consulting company.

The consequences of the broadband bottleneck go well beyond a few annoyed consumers. The development of promising new Internet services and media that were once promoted as an integral part of the broadband revolution have been halted, too.

Internet advertising and commerce, for example, are in a deep freeze. Yahoo! Inc. spent \$5.7 billion two years ago to buy broadcast.com, which makes it possible to deliver video programming over the Web. The investment has gone nowhere so far because there aren't enough broadband users to watch such programs. Moreover, advertisers can't replace banner ads, which have been largely ineffective, with the more sophisticated, live-action ads that broadband would allow. "To think that you were going to support the development of new program-

ming with banner ads was crazy. What were they smoking?" says Jonathan Taplin, CEO of Interntainer Inc., which provides Hollywood movies over the Web. The company, backed by General Electric, Microsoft, and others, has only 40,000 paying subscribers.

Already, a host of digital-media companies, such as Pop.com, Digital Entertainment Network, and Pseudo Programs, have gone bust. Certainly, their business plans, with their dependence on advertising, were ill-conceived. But it didn't help that consumers weren't inclined to watch short films over slow dialup Web connections. "Consumers do

dNet. The problems are hurting consumers and small businesses alike. In March, for example, Franchise Pictures was in the final stages of editing the v-released movie *Driven* when Northpoint filed for bankruptcy. Franchise Pictures was using Northpoint's DSL service to transmit digital footage of the Sylvester Stallone action flick among five separate studio buildings. Suddenly, Northpoint halted its service. The film company was forced to interrupt editing and hire a new provider, wireless upstart taWire, could be lined up. By then, production had slipped several weeks behind schedule.

Given DSL's troubles, you'd think cable operators would be able to capitalize on it to build their competing cable-modem businesses. But that hasn't been the case. Although 70 million of the country's 105 million households have access to cable TV, and about 60 million have access to cable modems, less than 10% of those have signed up for the service. That's because cable companies aren't marketing it as aggressively as the roll-out of their higher-margin digital-TV services. "I think the pace of broadband deployment on the national level, beyond a few select markets, is very disappointing," says Chris-

BROADBAND BLUES

Still years away for most consumers, the limited availability of high-speed Net access is putting the brakes on a myriad of once-promising new markets.

Source: BusinessWeek, Lehman Brothers

Advertising

Dismayed by ineffective banner ads, Madison Avenue has been pining to put multimedia spots on the Web. Without broadband, that won't happen.

E-Commerce

Faster Internet connections should encourage more spending online. AOL generates about \$7.75 a month per user in advertising and commerce revenue in the slow-speed world. That should double in the high-speed era.

Digital Media

Startups such as Pop.com, Pseudo Programs, and Digital Entertainment Network have gone out of business. Few people will watch short films on a tiny screen with the jerky motion of slow connections.

Interactive TV

A slew of hyped new TV services, such as the ability to find sports statistics online while watching TV broadcasts, have been pushed back until high-speed access gains a mass market.

not buy speed for speed's sake. Streaming audio or video? It's called your TV or stereo," says Barry M. Schuler, chairman and CEO of the America Online unit of AOL Time Warner Inc.

The bottleneck has also slowed the development of e-commerce. Broadband users are twice as likely to buy things online as slow-speed users, says Joe Laszlo, a broadband analyst at Net researcher Jupiter Media Metrix. AOL generates about \$7.75 a month in advertising and commerce revenue per user. That's expected to roughly double in the high-speed world, Sanford C. Bernstein & Co. said in a January report.

With such pots of gold at the other

end, you'd think there would be a mad rush by telecom and cable companies to get in gear. Whatever happened, for instance, to the much-hyped plans to hook fiber-optic connections directly into homes? Fiber connections run as much as 160 times faster than DSL lines. They can easily accommodate high-speed Net access, digital TV, phone, and videoconferencing on a single line. But with the capital crunch putting telecom expansion plans on ice, these connections remain limited to expensive, urban locations and a few small municipalities such as Norton, Kansas, and New York Mills, Minn. Says Darryl Ponder, CEO of Optical Solutions, which makes optical gear for the residential mar-

ket: "It will be at least 15 years before we see widespread deployment."

But even providing DSL has proved much tougher than expected, thanks to a host of technological hurdles in transforming the entire national infrastructure to broadband. DSL is a digital Internet service grafted onto an old analog phone system, and DSL gear takes up a lot of space. There's plenty of room to store it in large towns and cities, where phone companies build multimillion-dollar "central offices" for their switching equipment. But in small towns, carriers keep their gear in outdoor cabinets that have no room for DSL equipment.

In large markets, DSL is often inco-

COMMENTARY

By Steve Rosenbush

LUCENT: SUDDENLY, THE HOLE IS EVEN DEEPER

On the morning of May 29, Alcatel's acquisition of Lucent Technologies looked like a done deal. The companies had already sent advance troops to New York for a press conference. A meeting hall had been reserved for the following morning at the St. Regis Hotel. Coffee and pastries for a cast of hundreds were waiting. All that stood in the way of the big announcement was a pair of board meetings to approve the \$24 billion deal. "When I woke up that morning, it sure felt like a deal that was moving forward," said one person close to the talks.

Anyone need a couple of hundred pastries? By late afternoon, both companies issued a joint statement saying the talks had been halted, scuttled by disputes over who would ultimately control and run the merged company. The sobering fact that both lost value as the talks progressed didn't help, say people familiar with the matter.

POUNDED. For Alcatel, being jilted is a minor embarrassment. But the entire weeklong charade will haunt CEO Henry B. Schacht and a much-wounded Lucent for months, and possibly years, to come. Lucent has lost ground since secret negotiations began back in March, and it is clearly even worse off than it was when news of the pending deal broke on May 18. For starters, long-suffering shareholders have been hammered once again: Shares fell \$2, to \$8, during the talks

and are off 88% from a 52-week high of \$63. Tense divisions within its management ranks have been exposed. And would-be suitors now know the easy terms that Lucent is willing to accept. But perhaps most damaging is the perception management has created that it doesn't believe the company, whose beginnings go back to Alexander Graham Bell's original research labs, can thrive on its own.

REALITY BITES

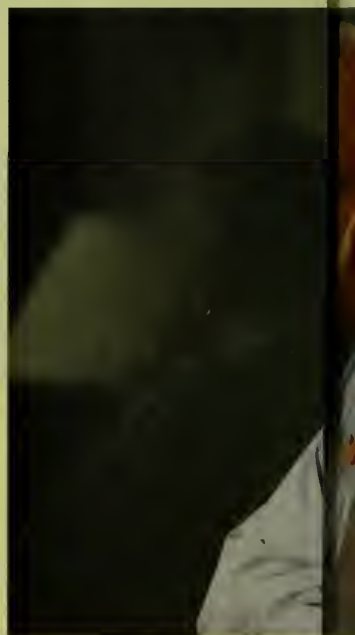
The failed Alcatel deal has created the perception that management doesn't believe the company can thrive on its own

CEO SCHACHT MAY HAVE A HARD TIME RETAINING KEY EXECUTIVES

As details of the Alcatel talks emerge, questions are already rising about Schacht's motivation to do the deal. Indeed, well before the news hit that Alcatel was making a play for Lucent, Schacht was out quietly peddling his company to any European telecom company that would listen. Trips to Europe in late February and early March with Vice-Chairman Bernardus J. Verwaayen, a former KPN executive, says one person familiar with the matter, yielded merger talks with a number of companies, in-

cluding Siemens, Marconi, Nokia and, of course, Alcatel. As the Alcatel talks progressed during April, Lucent began crowing about how its second-quarter results demonstrated that its recovery was under way. The evidence: Revenues in the second quarter were 36% higher than revenues in the first, a \$1.8 billion operating loss notwithstanding.

Now investors have to wonder how strong the turnaround is. "After the Alcatel episode, investors are going to be skeptical. If things are going so great, why



patible with older copper phone lines. But carriers don't know which lines will be incompatible—and costly to convert—until they start work in each neighborhood. “We have consistently said it would take much longer to roll out [broadband] than anyone thought,” says AOL’s Schuler. “DSL and cable modems have unique sets of challenges that we’re able to roll them out ubiquitously.” Regulatory policy hasn’t helped matters. SBC Communications Inc. pulled out of Illinois’ DSL market after state regulators ruled that the carrier must share its new network with rivals. The Illinois complain that requiring them to share their networks with rivals puts them at a disadvantage to cable companies. In Portland, Ore., local officials tried to impose phonelike rules on AT&T’s

cable business. But the effort was shot down in court. Some members of Congress and the Federal Communications Commission believe that a bill easing restrictions on the Bells from offering long-distance service would encourage broadband deployment. Newly appointed FCC Chairman Michael K. Powell wants to ease the regs but aggressively enforce those that remain by proposing to more than double fines for shutting out local competitors. “The commission overregulates everything. And broadband gets caught in that,” says former FCC Commissioner Harold Furchtgott-Roth.

Put it all together, and the broadband revolution sounds a lot more like a broadband bummer. Carriers say they have learned from their mistakes. “We still have a long way to go, but we’ve

made tremendous improvement,” says Fred D’Alessio, president of the advanced-services group at Verizon Communications Inc. Those improvements need to keep coming. Otherwise, consumers like Evan Petrie, who have the patience to wait six months or longer for their service, might just give up.

By Steven Rosenbush in New York, with Dan Carney and Amy Borrus in Washington, Tom Lowry and Peter Elstrom in New York, Charles Haddad in Atlanta, and Ron Grover in Los Angeles

BusinessWeek online

For an online report on wireless broadband go to the May 17 Daily Briefing at www.businessweek.com



think about selling out?” says Levy, telecom-equipment analyst at Robert Brothers Inc. “It sets back the effort to restore their credibility in the financial community.” But what was Henry Schacht? Although the talks were on-going for months, the deal never came through. Over his command, it would have been a good idea to have a long-term deal. That Alcatel would walk away with a 58% stake in the new company, and that it

would name the chairman and CEO.

That’s why many Street and industry observers think Schacht was really looking for an eleventh-hour excuse to quash the deal after investors clearly signaled their displeasure with it. “The financial issues played a larger role in this than most people realize,” says Paul Johnson, telecom-equipment analyst with Robertson Stephens.

BIG SPLIT. The financial community isn’t the only group whose confidence has been shattered by the derailed merger. The episode has also split management in two. Schacht and senior leaders such as Executive Vice-President Bill O’Shea supported the Alcatel deal until it fell apart. Younger managers wanted Lucent to wait a few quarters, until the turnaround was further along, people familiar with the matter say. Then it could either go it alone or negotiate a better deal with a potential partner. Now it may be more difficult to retain key executives.

Lucent, though, is going to need to keep all the talent it can to weather the next year. The company faces no immediate cash crunch: It had \$1.4 billion in cash at the end of March and access to \$3.5 billion in short-term credit, which can be used to pay off \$750 million in debt that comes due this summer. But it

still carries a heavy net debt load of \$4 billion and needs to strengthen its balance sheet through asset sales. Its optical-fiber unit is already on the block, and Lehman analyst Levy expects its sale will raise \$3 billion to \$5 billion.

Such sales will buy time. But Lucent will now have to turn back to the tough slog of sorting out its problems without help from a stronger partner. That means getting back to operational basics. Lucent still has a long way to go before it delivers on its promise to cut \$2 billion in costs. It has already slashed 10,000 jobs but may need to cut 10,000 more. It is also nowhere near its goal of reducing receivables and inventory by \$2 billion.

Even if Lucent could accomplish all that, there’s still the problem of getting the right products to market at the right time for a new world of digital data and fiber optics. That won’t happen until the company finds new leaders who aren’t cut from the same telco cloth as the current regime. And the company still needs to find a successor to the 66-year-old Schacht.

As for the botched Alcatel deal, it was a bizarre, if fitting, end to the latest chapter in Lucent’s rapid decline. Although Alcatel CEO Serge Tchuruk agreed to move to the U.S. to head the

combined company, Lucent still wanted soothing assurances about a merger of equals. But that was never in the cards. Now Lucent must face the music on its own.

Rosenbush covers telecommunications from New York.

REWIRING LUCENT: SCHACHT’S TO-DO LIST

CUT COSTS The company promised in January to reduce annual costs by \$2 billion but has hardly made a dent. Schacht is trimming 10,000 jobs, but he needs to double that.

SELL ASSETS Lucent badly needs cash. Its optical-fiber unit could fetch from \$3 billion to \$5 billion.

BOLSTER FINANCIAL CONTROLS Schacht must follow through on vow to slice inventories and accounts receivables by \$2 billion.

FIND A NEW CEO Until Schacht ends the seven-month-long search for his successor, uncertainty will continue.

COMMENTARY

By Howard Gleckman

THE TAX CUT THAT GOT AWAY

It's easy to spot the corporate tax lobbyists in Washington's ritzy restaurants these days. They're the ones glumly ordering that third—nondeductible—martini.

Business reps began the year on an odd note: At the behest of White House politico Karl Rove, they were pressed to support a tax cut that conspicuously omitted business preferences. The payoff: Cuts for Big Business would follow in a second bill. Now, President Bush has his \$1.35 trillion tax bill in hand, but Republicans' loss of Senate control has complicated Corporate America's drive for a promised package of business incentives.

CEOs could still gain some goodies this year, mostly by attaching provisions to a few high-priority bills that don't have anything to do with tax cuts. The two best bets: a Democratic-backed plan to hike the minimum wage and a bipartisan drive to extend the life of expiring tax preferences for exporters and others.

For the most part, though, business priorities are on the back burner. These include new tax benefits for companies that purchase equipment, a broad reform of tax rules for U.S. multinationals, making the R&D tax credit permanent, and capital-gains tax cuts. In the new Democratic Senate, issues such as patients' rights and a prescription drug benefit will take priority over tax-cutting.

Democratic rejiggering isn't the only obstacle. The sheer size of Bush's cuts has complicated the plans for business. On paper, the President's proposal is worth \$1.35 trillion.

But Congress left out the final-year cost and failed to fix an alternative minimum tax that could slash the benefits for 30 million taxpayers. As a result, its real cost will top \$2 trillion over 10 years. A planned Pentagon push for at least \$30 billion a year in additional spending could drain whatever is left. Says Philip J. Wiesner of KPMG: "The question is whether there is going to be any money left for a corporate [tax] bill."

The biggest loss for the business community may be a delay in the drive for faster write-offs of capital equipment.

also try to raise the deduction for meals and boost the amount business can write off for office equipment. "I wouldn't be surprised to see \$40 billion to \$50 billion" in new breaks over 10 years, says Clint Stretch of Deloitte & Touche.

OVERSEAS. Business reps will get another shot when lawmakers move to extend a handful of expiring tax breaks. The most important: a provision that allows some companies to defer paying tax on overseas investment income. This could save \$7 billion for banks and other financial-services companies, as well as U.S. manufacturers that finance their own exports.

Despite chilly prospects in 2001, the Gucci Gulch set still has three years of Bush

On Hold

Some postponed items on the corporate wish list:

CAPITAL GAINS

Business wants the 20% rate on capital gains cut. But a break for big investors now looks unlikely.

DEPRECIATION

New write-offs for buying capital equipment were on deck, but no longer. Such a change would cost hundreds of billions.

RESEARCH CREDIT

Business hoped Congress would permanently extend the temporary credit this year. With expiration not set until 2004, it's no longer a priority.

FOREIGN TAXES

Many want a restructuring of taxes on U.S. multinationals. But business has never agreed on how to do it, and a transition to a new system could be costly to the Treasury.

With a price tag of up to \$400 billion, the plan looks too costly. It will be pushed into the future.

In place of sweeping revisions, business supporters will have to pick carefully. Their first opening will be when Democrats try to hike the minimum wage. Some Republicans would back such an effort—if it included small-business tax cuts. That might mean bigger deductions for health insurance purchased by the self-employed, for example. Lawmakers may



rule to make its case. If the economy rebounds, funds would be freed up for more tax relief. But early estimates by the Congressional Budget Office suggest no looming windfall, pointing to extended trench warfare for lobbyists.

Of course, none of this is to suggest that CEOs are crying over Bush's individual cuts. The breaks offer benefits for upper-income taxpayers and, execs hope, will light a fire under consumer spending. But their joy is tempered by the realization that when it comes to their own companies, tax relief could be a long-term proposition indeed.

Gleckman covers tax policy from Washington, D.C.



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THE SENATE

A NEW BANKING CHAIRMAN ENTERS FROM STAGE LEFT

Wall Street nemesis Sarbanes will champion the consumer

Only hours after Vermont Senator James M. Jeffords announced his defection from the Republican Party on May 24, the Democratic chair-apparent of the Senate Banking Committee, Paul S. Sarbanes, called a briefing to talk up his plans. As the Maryland Democrat entered the Banking Committee's hearing room, New York Representative John J. LaFalce—Sarbanes' ideological and policy soulmate—marched up, fell to one knee, and kissed his ring.

LaFalce won't be the last in that position. The Democrats' takeover of the Senate has flipped Washington's agenda for financial services. Consumer-oriented issues that outgoing Chairman Phil Gramm (R-Tex.) wouldn't give the time of day—stronger financial privacy, predatory lending, credit-card abuses, and growing household debt—will now seize the spotlight. Facing this unexpected challenge, lobbyists for banks, brokers, and insurers are lining up to court Sarbanes.

PRIVATE WAR. But can Sarbanes reap more than obeisance from his fellow senators? More likely, the 68-year-old Baltimore native will have a tough time getting any legislation passed. He faces a Banking Committee that's conservative on both sides of the aisle and a narrowly divided Senate. And even if Sarbanes can push bills through the Senate, House Financial Services Committee Chairman Michael G. Oxley (R-Ohio) isn't inclined to take up what a GOP aide calls "Sarbanes' ultra-left financial agenda."

Still, if any issue can break through this gridlock, it's privacy, a favorite of Sarbanes. Since 1999, he's been pushing legislation to limit the consumer information that financial firms can share with other businesses, with mixed results. The 1999 Gramm-Leach-Bliley Act allows consumers to bar any transfer of account information when, for example, a broker sells its account lists. But banks, brokers, and insurers

can freely share customer data in-house with other divisions.

Now, Sarbanes wants to require firms to give consumers a chance to opt out of that in-house sharing too. He may have a chance. He has allies across the aisle. More important, "members of Congress



NEW AGENDA

With Sarbanes in and Gramm out, issues such as financial privacy and predatory lending are back on the table



find it difficult to vote against anything labeled 'privacy,'" concedes Edward L. Yingling, head of government relations for the American Bankers Assn.

Nevertheless, privacy advocates aren't guaranteed a win. Most leaders in Congress want to see how the 1999 rules work before they reopen that hard-fought law. And financial industry

lobbyists say Sarbanes' leverage is weak. "There's no 'must-pass' bill the Sarbanes can hold up to make us swallow his proposals," says a bank lobbyist.

The Senate switch may mean both parties rely more on rhetoric to support their agendas and less on legislation. Some Democrats would like an immediate crackdown on predatory lending, the practice of offering high interest loans to poor and uneducated borrowers. But Sarbanes has expressed support for regulators, who want to build up enforcement of existing fair-lending rules before Congress acts. House Republicans, for their part, would like no limits on Fannie Mae and Freddie Mac, the government-backed mortgage lenders. Sarbanes is likely to block that push.

His control of the Banking Committee may also force Bush to moderate his choices for SEC commissioners. Harvey L. Pitt, a Washington lawyer nominated as chairman, should sail through. But with one seat left to fill, Bush's deregulation-minded nominees will have a tougher time clearing Sarbanes' committee.

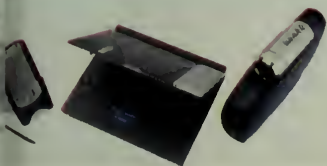
COLD COMFORT. Indeed, the securities industry may face its most changed prospects. Sarbanes won't push Gramm's effort to cut transaction fees paid by investors and boost pay at the Securities & Exchange Commission. Nor will the Marylander pursue Gramm's planned top-to-bottom view of securities laws. As a result, Wall Street won't have a chance to roll back some targets such as conflict-of-interest rules for brokers who both advise and sell stocks to mutual funds—that it had hoped to get rid of.

That's not the only reason Wall Street will miss Gramm. The Texas didn't hesitate to step in when the SEC proposed cracking down on accountants or when Nasdaq pitched a new trading system that would have hurt rival electronic traders. Now, Sarbanes says he'll hear industry complaints, but "they may not necessarily get their way."

Even if few of Sarbanes' ideas make it into the law books, that will provide little comfort for the financial services industry. A cold shoulder for Wall Street and warm greetings for consumer advocates is reversal enough from the past six years under Gramm.

By Christopher H. Schnutt and Michael McNamee in Washington

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AUTOS

FORD VS. FIRESTONE: A CORPORATE WHODUNIT

Is it the tires or is it the Explorer? Here's the story so far

Ten months after the recall of 6.5 million Firestone tires on Ford Explorers linked to deadly rollover accidents, the root cause of the safety crisis remains a mystery. Is it merely a case of lousy tires, as Ford Motor Co. claims? Or is the design of the Explorer partly to blame, as Firestone contends?

In the latest round of allegations, Ford charged on May 22 that it had found damning new evidence against Firestone tires. As Ford hurried to carry out a voluntary recall of some 13 million Firestone tires, an outraged Firestone countered with its own data purporting to show that the Explorer itself is part of the problem. So far, the corporate blame game has created a lot more confusion than clarity. Nor can worried consumers look to the National Highway Traffic Safety Administration—the federal agency charged with getting to the bottom of the dispute—for answers. Its findings are still months away. Who and what to believe in the meantime? Here's a roadmap through the jungle of competing claims.

Last summer, Ford insisted the tires not recalled by Firestone were safe. Now it wants to replace them. Are they safe or not?

Ford concedes many of the tires it is replacing "do not have a significant risk of failure." Yet after comparing the performance of Firestone's Wilderness tires with those of other brands, Ford says it lost confidence in their safety. Why? Ford says the latest batch of claims data it received from Firestone on May 11 showed that the failure rate for Wilderness AT tires was "trending upwards." Ford says its own lab tests, which included chemical analyses, computer modeling, and tire endurance tests, also suggested some tires were indeed more likely to fail over time, usually after three years.

At Ford's request, NHTSA compiled field data on 10 other high-volume, SUV tire lines, made by three different manufacturers. While NHTSA didn't disclose which tire lines it compared, all the other brands typically failed at a rate of

only 5 per million. That compares with a failure rate of 15 per million for the Firestones. So, is the latter a significantly worse failure rate? Privately, government investigators say yes. But some experts believe Ford is overreacting. "Ford is being extra careful and cautious," says James Wangers, a senior analyst at Automotive Marketing Consultants Inc., an auto testing outfit in Warren, Mich. "It is as much PR-motivated as it is genuinely good business."

Firestone has yet to respond to the specifics of Ford's take on the NHTSA data. But Firestone defends all tires not recalled last summer. Still, Ford has other ammunition: In the 1995-1997 model years, half of the Explorers Ford produced had Firestone tires; half had Goodyears. Both companies designed their tires to meet the same standards set by Ford. Yet while Firestone has recorded 1,183 tread-separation claims on those tires, Ford says Goodyear has received only two claims. Firestone says it is unclear whether Goodyear defines a "claim" the same way it does. A spokesperson also notes that Ford's own memos on file with Congress suggest that Goodyear tires may have separated more than the data show. The bottom line: Unless Firestone comes up with more compelling data, Ford's stats don't look good for the tiremaker.

But what about the possibility that the Explorer's design is partly to blame for the tire failures?

Firestone says it has hired an outside expert to conduct an engineering analysis of the vehicle. In the meantime, Firestone says its claims data show that tread separations on the Explorer occur 10 times as often as on the Ford Ranger pickup, which uses the same



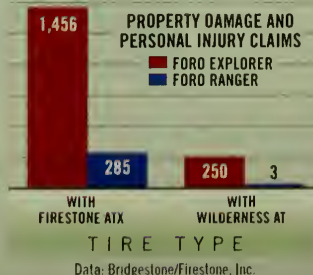
tires and is built off the same chassis.

But is that a valid comparison? Most experts say no, because the Explorer weighs more and has a higher center of gravity. "It's an apples-to-oranges comparison that has no validity in my opinion," says Brian O'Neill, president of the Insurance Institute for Highway Safety. Nor does NHTSA appear convinced.

Considering the data, one of Firestone's

Who's Right?

Firestone argues that Ford Explorers are more accident-prone than Ford Ranger pickups equipped with the same tires...



ROLLOVER: A



W RUBBER: Ford concedes it's recalled tires with no "significant risk"

ongest arguments against Ford's den-
n, the tire company has hardly mount-
a convincing case so far.

there any other evidence that shows
Explorer is more prone to roll over
n other suvs when tires fail?
Hard to say. Crash statistics main-
ned by the insurance industry and the

federal government show the four-door Explorer has a lower rate of fatal rollovers than other SUVs. But no one has yet studied whether a tire failure on an Explorer is more likely to result in a rollover. Firestone has attempted to do that by analyzing crash data in Florida and Texas. By studying tire-related accidents from 1993 to 1999, Firestone concluded that the odds of an Explorer rolling over are greater than that of other SUVs. Of 91 tire-related Explorer crashes in Florida, for instance, 74, or 81%, involved a rollover. In 221 tire-related accidents involving other SUVs, 151, or 68%, involved a rollover. Is that enough of a difference to draw a conclusion? Not so far. "It's entirely possible that there is something about the design of the Explorer that does make it prone to roll over given a tire failure," says O'Neill. "But nobody's come up with a hypothesis to explain that."

Are there other design issues that may be contributing to the increased risk of tire failure or rollover?

Ford considered various engineering modifications to deal with the instability of Explorers during their original design phase in the early 1990s. Instead, it settled on a fairly simple fix: deflating the tires. By recommending the Explorer's tires be inflated to 26 pounds per square inch (psi) instead of Firestone's recommended 30 psi, Ford was able to ensure a more stable ride and reduce the rollover risk.

But that led to another problem. The lower tire pressure increased the friction between the tire and the pavement, resulting in lower gas mileage. So Ford, which was under pressure to meet government fuel economy standards, asked

Firestone to make the tires lighter, according to advocacy group Public Citizen. Firestone removed weight from the tires by reducing its rubber and steel components. But that made the tires less durable—and more susceptible to tread separations, say safety advocates. Ford responds that the design, not the weight, determines the strength of the tire.

Ford claims it has made the redesigned 2002 Explorer a lot safer than the ones involved in the roll-overs. So, has the re-design eliminated the safety concerns?

Not really. It's true that the new four-door Explorer, which went on sale in March, is 2 inches wider and has an improved suspension, which makes it easier to handle and less prone to roll over. The vehicle offers numerous safety options, including rollover sensors, side curtain air bags, and electronic stability control. But not all new Explorers have been redesigned. The popular two-door Explorer Sport and the four-door Explorer Sport Trac, a combination pick-up-SUV, are still based on the old design.

And unlike its four-door sibling, the Explorer Sport already has one of the worst death rates in rollover accidents, according to the Insurance Institute for Highway Safety.

So where is NHTSA in all this? If Ford really has proof that Firestone tires are riskier than others, why isn't it being more aggressive in protecting consumers? And why hasn't it investigated the Explorer's design?

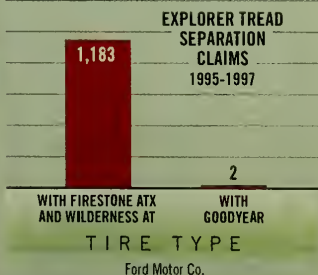
NHTSA has been studying the tire issue since May, 2000, and had promised to wrap

up its probe within six months. Now, it's saying it will be finished by the end of summer, at the earliest. Although critics charge that NHTSA is dragging its heels, the agency is hamstrung by Congress, which has starved it for funding since the 1980s.

Watchdog groups also complain that NHTSA, under pressure from the auto industry, has yet to open a separate investigation into the Explorer's design, despite Firestone's claim that the SUV plays a role. NHTSA's own data show Firestone tires fail at a greater rate on the Ford Explorer than on any other SUV. That in itself ought to be reason enough to investigate the Explorer too. "For some reason, a Firestone tire on a Ford Explorer is a deadly combination. There should be two investigations," says Joan Claybrook, a former NHTSA administrator. Now, after an infusion of new funding following the Firestone-Ford fiasco last year, the safety agency is moving ahead with a new test to assess the likelihood of rollovers on all SUVs and to provide real-world rollover ratings. Not a moment too soon.

By Joann Muller in Detroit, with Nicole St. Pierre in Washington

...But Ford insists that Firestone tires are more likely to fail on Ford Explorers than are other tire brands



STRATEGIES

FIRESTONE: IS THIS BRAND BEYOND REPAIR?

It faces plummeting sales—and possibly sky-high legal costs

Bridgestone/Firestone Inc. CEO John T. Lampe was feeling pretty good for a change. As he stood in the Indianapolis Motor Speedway's famed Gasoline Alley just hours before the start of the Indy 500, racing dignitaries such as driver A.J. Foyt stopped by to shake his hand. Since Firestone is the event's exclusive tire supplier, for a change, no one could refuse his company's treads. Still, it wasn't much of a respite. Lampe spent much of the race trying to reassure his biggest dealers that Firestone will get past its year-long crisis.

Indeed, outside the famed racegrounds, Firestone's outlook is increasingly bleak. On top of the 6.5 million flawed tires Firestone was forced to recall last August, Ford Motor Co. announced plans on May 22 to replace another 13 million Firestone tires it believes are unsafe; a furious Lampe then severed ties with his biggest customer. Firestone's sales could plummet 20% this year, profits have disappeared, and both customers and tire dealers alike are fleeing the Firestone make, yet Lampe appears to have little clear strategy for stopping the slide. "You have a serious risk of the Firestone brand imploding," warns Lehman Brothers analyst Nicholas Lobaccaro.

"BANKRUPTCY?" How bad will the financial hit get? Cutting ties with Ford will cost the company 4% of its \$7.5 billion in revenues—about 40% of its sales to car companies. And the U.S. division of the Tokyo-based Bridgestone/Firestone expects to lose \$200 million this year.

But that figure may be low. Mounting damages awards from rollover suits and legal bills could easily top the

company's \$463 million legal reserve. And if the National Highway Traffic & Safety Administration supports Ford's recall, Firestone could find itself liable for much of the \$3 billion cost.

For now, most think the company will survive. Bridgestone Corp. has \$900 million in cash and good relations with its bankers, says Commerzbank Securities analyst Clive Wiggins in Tokyo. Still, if its legal woes worsen or its tire sales continue to falter, "at some point it behooves them to file for bankruptcy," Lobaccaro says.

But Firestone's dealers would like Lampe & Co. to do a better job of shoring up the brand. For now, his company's two-month-old ad campaign touting the safety of its tires is getting drowned out by Ford's recall and its accompanying ads. Says Steve Grey, owner of Grey's Wholesale Tire in Fort Worth: "The consumer has been overwhelmed with negative information about Firestone."

Indeed, even before the latest rift,

sales of Firestone's replacement tires were down by 40%, says Lobaccaro. Since replacement tires are Firestone's most profitable line—making up about \$4 billion of its revenues and nearly half its profits—that hurts. And consumer fears are clearly growing. "If [Ford and Firestone] don't have confidence in each other, why should we?" asks John Maras as he shops for a new sport-utility vehicle in East Boston.

If you're not certain about safety, you stay away.

Lampe counters that General Motors Corp. believes Firestone's tires are safe and plans to continue using them. He's also crossing his fingers that NHTSA won't support Ford's allegations. But critics say Firestone can't wait

CEO LAMPE AT INDY
A high profile in racing won't save Firestone's image



the government to give it a clean record. Michael Sitrick, chairman of Sitrick & Co., a corporate crisis management firm, says Firestone has spent too much time blaming Ford when it should be trying to convince consumers its tires are safe.

Lampe is also counting on building the parent company's Bridgestone name into a mainstream brand—a shift many analysts agree would help. But consumers may not be fooled. A May survey done by Total Research Inc., a firm that ranks consumers' perceptions of brands on a scale of 1 to 10, shows that Bridgestone sank to 5 from 6.7 a year ago. Firestone tumbled worse, from 7 to less than 4.

Even GM admitted it would prefer to use Bridgestone name for its 14 Firestone-clad vehicles. Says GM advertising general manager John G. Middlebrook: "As a marketer, I'd rather use the Bridgestone name just to take away the question in consumers' minds. Problem is, consumers may have that question pretty firmly planted already."

By David Welton
Indianapolis

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PR WARS

Goodyear, whose Explorer tires have held up well, is gaining from its rival's woes

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COMMENTARY

By Ronald Grover

WHO WINS IN THE SMACKDOWN OVER DIRECTV?

It would be hard to find two more fierce media rivals than Charles W. "Charlie" Ergen and Rupert Murdoch. Ergen, the satellite-dish salesman turned satellite mogul, once gave away free dishes to the entire town of Boulder, Colo., to steal cable customers for his EchoStar Communications Corp. Murdoch isn't stingy, either. The News Corp. chairman gave away tons of free dishes—and took \$2 billion in losses—to launch British Sky Broadcasting Group PLC satellite service.

Now, the two are battling over General Motors Corp.'s DirecTV, the leading U.S. satellite company, with nearly 10 million subscribers and an estimated \$5.6 billion in 2001 sales. So far, Murdoch is the odds-on favorite. Ergen still needs backers for a \$5 billion bid to buy out GM's 30% stake, while Murdoch has already secured his financing and has been talking to GM for months. It's likely a bidding war will follow.

Whoever wins, the deal will give federal regulators pause: Ergen, because he'd control the only satellite service in America, and Murdoch, because he would be adding to an already mighty media armada that includes a global satellite network and the Fox TV network and studio. Would the public be well served by either guy getting his hands on the nation's third-largest TV subscription service, after cable companies AT&T and AOL Time Warner Inc.?

You bet. In fact, if you want more TV at lower prices, Ergen's your guy. With DirecTV, he could save customers millions by shutting down overlapping uplink centers—the units that send transmissions. Meanwhile, by combining the EchoStar and DirecTV satellites, he would be able to offer more programming, including local channels, in double the 40 regions he now serves. History tells us that people moved from free TV to

cable and now to satellite because they get more channels at an affordable price. Ergen understands that better than most: Only after his subscriber base grew 48%, to 5.7 million, last year did he up the price for his most popular service—yet his prices still beat cable's.

How long Ergen can undercut cable is unclear. Even before a potential DirecTV deal, his company had \$5 billion in debt. And in its most recent quarter it lost \$167 million. A merger with DirecTV will cut

Murdoch's advantage—which consumers might benefit from, at least in the short term—is a firm grip on programs and other services. He already controls huge amounts of programming, from sports to movies. Spreading the costs of that programming over more subscribers in satellite services throughout the world would let him keep rates down for subscribers

in the U.S. He can also drive down the costs of set-top boxes in the U.S. by buying in bulk. He would also be able to bring in programming to his satellite customers that wouldn't be available to cable. That's what he did

in England—at first. But in recent years, now that most British households get sports and movies from Murdoch, he has hiked rates 10% annually, says ABN Amro Holding analyst Michael Hilton. "Once he's got you, he's like a drug dealer," says Hilton.

That's why U.S. regulators ought to put conditions on any deal it approves, be it with Murdoch or Ergen. Take the 30 million

rural TV owners who can't get cable TV. With only one satellite company to serve them if Ergen wins, regulators should ensure they get the same rates and services other satellite subscribers get. If Murdoch wins, he should be required to offer competing cable operators the same terms he'll charge his U.S. satellite subscribers for Fox Sports, Fox News, and other cable channels.

Even then, cable operators won't be happy with a more powerful satellite operator in their midst. But that's the point. If they want to survive, they'll have to lower rates or offer more channels. Then, the true winner will emerge—the folks sitting at home with the remote control.

Grover covers the media industry.

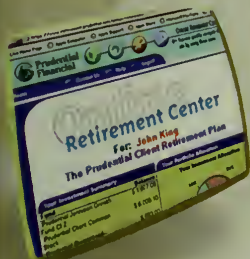


Whether it's Ergen or Murdoch, the couch potato with the remote really wins

some marketing costs, but cable is already stepping up marketing of digital channels and data to compete with satellite. That's why Ergen needs investors, such as his rumored alliance with BellSouth Corp. and Deutsche Telekom. But that tie-up will come at a cost: Ergen will no doubt be pushed to offer high-speed data over satellite, currently a tough technological trick that will eat into his earnings.

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In Business This Week

EDITED BY JOHN PROTOS

TYCO JUST GOT BIGGER—AGAIN

THE MAN SOME CONSIDER THE king of acquisitions—Tyco International Chief Executive Officer Dennis Kozlowski—is stepping up his already-frantic dealmaking pace. On May 30, Kozlowski announced an agreement to purchase C.R. Bard, a Murray Hill (N.J.)-based manufacturer of medical products, for \$3.2 billion. The acquisitive CEO has now closed or announced a record \$22 billion worth of deals since the company's current fiscal year began on Oct. 1. The addition of Bard—which racked up revenues of \$1.1 billion last year selling everything from cancer to specialty surgical products and services—will increase annual revenues of Tyco's booming health-care businesses to

\$9 billion, up about \$5 billion from last year.

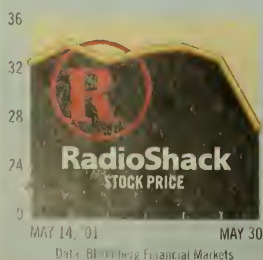
SUN UNDER A REVENUE CLOUD

HIGH TECH'S MEAN SEASON continues. On May 29, Sun Microsystems preannounced weaker than expected fourth-quarter revenues. With sales between \$3.8 and \$4 billion, Sun is facing a hefty drop from \$5 billion in last year's fourth quarter, when dot-com sales were still roaring. The newest culprit: slow demand for servers in Europe. The maker of servers and software for the Internet is also finding some customers are waiting to buy its upcoming higher-power family of Ultra-Spare III servers. Some analysts say Sun will feel its dot-com hangover for some time. "It'll be three quarters before we see positive revenue growth," says Salomon Smith Barney's John Jones Jr.

CLOSING BELL

RADIOSHOCK

Shares of RadioShack tumbled 18% on May 30, to \$27, the day after the consumer-electronics giant warned that second-quarter profits would trail expectations. The Fort Worth-based company blamed slowing consumer sales of wireless phones and computers. Analysts say the sharp slowdown in wireless demand and stiff competition from rivals such as Wal-Mart Stores will keep RadioShack under pressure.



CONOCO'S CANADIAN EXPOSURE

IN THE BIGGEST TAKEOVER in Canada's oil industry, Conoco on May 29 agreed to buy fellow oil and gas concern Gulf Canada Resources for \$6.3 billion in cash and debt. Thanks to high energy prices, cash-rich companies are rushing to build their portfolios while oil supplies are short. Houston-based Conoco, the nation's fourth largest oil company, says the Gulf Canada deal will boost its North American proved natural gas holdings by more than 50%, to 1.4 billion cubic feet per day. The deal, approved by both boards, is expected to close in the third quarter.

EMC: ANOTHER TECH LEADER FALTERS

EMC ANNOUNCED ON MAY 29 that it will cut 1,100 jobs, or

HEADLINER: CASEY MARTIN

'I THINK THIS OPENS THE DOOR'

CASEY MARTIN'S GOLF GAME has been in the rough lately. Playing on a minor-league tour this year, the former PGA player hasn't finished above 34th place.

But the 29-year-old who suffers from Klippel-Trenaunay-Weber syndrome, a rare circulatory disorder, just scored a legal hole-in-one. On May 29, the U.S. Supreme Court, in a 7-2 opinion, upheld a lower court ruling requiring that the PGA Tour allow him to ride a motorized cart during tournaments.

"I think this opens the door for people," says

Martin, whose disease has left him with a withered right leg that makes walking nearly impossible.

Martin, an ex-teammate of Tiger Woods on Stanford University's golf squad, filed suit against the PGA Tour 3½ years ago after being denied the right to use a cart.

The Tour took the position that Martin

would gain an unfair edge over other golfers if he was permitted to ride. With the court victory behind him, Martin can now move on to other businesses. Like lowering his scores.

Mark Hyma



4% of its workforce, in the next few weeks because of slowing sales. The data storage leader had been one of the last remaining strongholds in the computer industry, even going so far as pledging to hire 7,000 new employees at the beginning of the year. Now some doubt EMC will achieve its 2001 sales growth target of 20%. Goldman Sachs analyst Laura Conigliaro says EMC's sales may grow just 14%, to \$10.1 billion. EMC says the layoffs are part of a strategy to stimulate revenue growth.

Dell Computer and IBM plan to use the 64-bit chip for graphic-arts and online transactions processing to compete with market leader Sun Microsystems' server chip. Many analysts say sales are unlikely to improve the company's bottom line in the short term as customers wait for software applications to use with the chip. A few Wall Street are even predicting Itanium-based machines could cause a price war.

ET CETERA...

- President Bush rejected California's demands to improve electricity price controls.
- American Airlines attorneys vetoed arbitration, paving the way for a strike.
- The Nasdaq said it will cut 5% of its workforce.
- J. Howard Beales III, a tobacco critic, was named Federal Trade Commission consumer protection chief.

BIG INTEL CHIP INSIDE

IN A BID TO REINVIGORATE ITS profits in the face of slowing PC business, Intel on May 29 released its long-delayed Itanium microprocessor for high-end computer workstations and servers. Co-developer Hewlett-Packard, as well as

Never start
a sentence with
"If only I could..."

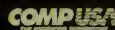


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PAULA DWYER

WILL THE NEW KING OF THE HILL OVERPLAY HIS HAND?

When he becomes Majority Leader on June 5, Senator Tom Daschle won't have much time to celebrate. The South Dakota Democrat has a 2001 agenda ambitious enough to make a conservative blanch. He hopes to hike a minimum wage and boost education spending. He wants to give patients the right to sue their HMOs and increase federal aid to farmers. And he wants to cap the soaring energy prices that are dimming the political hopes of California Governor Gray Davis, a onetime party star. It's a to-do list fit for a king of the Hill—and Daschle may need special powers to make it all happen.

Now that Jim Jeffords' party switch has given them control of the Senate, the Dems are thinking big. But some Democratic political pros warn that Daschle & Co. run the risk of overplaying their hand. "They're acting like they just picked up 10 seats," warns one top party consultant. Instead, some say, Daschle only wants to borrow a page from President Bush's playbook and focus on just a few top priorities. "There's no doubt we still have only 51 votes," says Washington Senator Patty Murray. "And it's going to be very difficult to [protect] a lot of what people want."

TO THREAT. Health care seems to have the most momentum, but even popular health measures could be troublesome. Within days of taking over, Ted Kennedy (D-Mass.), the new chairman of the Senate Health, Education, Labor & Pensions Committee, plans to move a patients' bill of rights, which the GOP had kept bottled up. He wants to give patients the right to sue for unlimited damages in relatively friendly state courts, while Bush only wants to give patients access to more restrictive federal courts and to cap damages. Daschle, of course, can send Bush the more liberal bill, but that would invite a veto he may not be able to override.

A Medicare drug benefit is also high on Daschle's list.

Pharmaceutical companies and their GOP allies favor a program that is privately run by health insurers and benefit-management outfits; Dems want the feds to run it. The problem for Daschle is that House Speaker J. Dennis Hastert (R-Ill.) is determined to move a drug bill this summer, which puts pressure on Daschle to follow suit. But some within his own party—Senator John B. Breaux of Louisiana in particular—also favor private-sector over government control. Daschle will have to find the middle ground among his own troops. If not, voters in the 2002 midterm elections could take revenge on the Democrats, who have often pledged to add a drug benefit to Medicare.



DASCHLE: A balancing act

The biggest test of Daschle's leadership could be his ability to hold the line on spending. During the debate over Bush's \$1.35 trillion tax cut, Daschle and his colleagues issued synchronized warnings that a mega-tax cut was fiscally reckless. Now that Democratic porkmeister Robert C. Byrd (D-W. Va.) is about to take over the Appropriations Committee, however, the party could stage a major spending spree—and forfeit any claim to responsibility. As Georgia Senator Zell Miller says: "The main problem that the Democrats have is that people don't trust us with their money."

Bush couldn't agree more with Miller, the Georgia Democrat who will be watching as

Daschle attempts to balance his party's interests between market-oriented, tightfisted moderates and proregulation, big-spending liberals. If Daschle moves too far to the left, Miller could jump to the GOP and return Senate control to the Republicans. Although Miller rules out such a move for now, Daschle will have to remain vigilant to keep him in the fold. In fact, the new Majority Leader may soon find his expanded powers are a mixed blessing indeed.

With John Carey and Lorraine Woellert

CAPITAL WRAPUP

STEEL'S FRESH HOPE

The GOP may be business' favorite party, but at least one industry is cheering the Dems' takeover of the Senate—steel. That's because Democrats on the Senate Finance Committee, including new Chairman Max Baucus (Mont.), are pushing for the U.S. International Trade Commission to investigate a flood of imports that have helped drive some U.S. steelmakers into bankruptcy. If the ITC finds that the companies were harmed, the U.S. could impose tariffs or quotas.

The White House has refused calls from industry and the United Steelworkers to get the ITC on the case.

BUSH IS WARMING

► Stung by the outrage abroad over President Bush's decision to reject the Kyoto Protocol on global warming, the Administration is feverishly working on a new approach. The goal: to unveil it before Bush's trip to Europe in mid-June. With ugly demonstrations expected by the Greens and others, Bush officials hope that a reasoned response will help defuse tensions.

CAPPING ENERGY COSTS

► The issue *du jour* in Washington is electricity price caps. Senator Dianne Feinstein (D-Calif.) is pushing a measure that would hold down the wholesale price of electricity until March, 2003. But President Bush made it clear in a May 29 meeting with California Governor Gray Davis that he is against price caps. And on May 25, new Energy & Natural Resources Committee Chairman Jeff Bingaman (D-N.M.) said: "We should not be writing into law any kind of price cap."

TAIWAN & CHINA

How can Taipei control its destiny as the two economies integrate?

Not so long ago, Microtek International Inc. was an icon of Taiwan corporate excellence. Its high-quality, affordable scanners were hot sellers around the world, and it consistently turned in handsome profits. Like many Taiwanese companies, Microtek's success involved moving much of its manufacturing to the mainland. It was part of an exodus of industry, from textiles to tech, that over two decades has capitalized on low labor costs across the Taiwan Strait. In recent years, however, Microtek has stumbled. Last year, it eked out a small profit, but the global slowdown has since walloped its operations.

Now, keen to reverse its fortunes, Microtek is viewing the mainland in a new light. No longer does it see the People's Republic as merely a manufacturing base. With global demand withering, Microtek now sees China as a market for its products. Moreover, as stock markets at home plumb record lows, the company is eager

to tap China's booming bourses. It plans to be among the first Taiwan companies to list in the mainland. "We have to concentrate on China more and more," says Microtek Vice-President Luke Liou. So much so, he says, that the China operations could soon be "bigger than the parent company."

WHERE ELSE? Microtek's flight from Taiwan underscores a seismic shift now under way in the economic relationship between Taiwan and China. The global slump and Taiwan's ailing economy are prompting a dramatic reevaluation in the island's boardrooms. With the U.S. sputtering and no other engines of growth in sight, Taiwan execs increasingly see China as their only salvation. Taiwan Inc. wants a major migration to the mainland, free of restric-

tions from Taipei. The reasons are many: to be close to multinational customers in China, to sell to the mainland market and to tap the cheaply priced brainpower of China's top academics. And Taiwanese know that with both sides gearing up to join the World Trade Organization this year or next, trade investment flows between the archipelago are certain to soar in the years ahead.

The new economic thinking in Taiwan seems at odds with the political situation. All the while, tensions are rising across the strait, owing in large part to the Bush Administration's tilt toward Taiwan away from China. Beijing is furious that the U.S. has agreed to the Taiwanese arms package. And Taiwan President Chen Shui-bian's mid-May stopover in the United States en route to La-



DESPERATE STRAITS

The Promise

- Taiwanese companies no longer see the mainland merely as a cheap manufacturing base but as a market for their products and a place to raise money
- Taiwan Inc. is pressuring the government to lift a ban on capital-intensive high-tech investments and eventually open direct postal, air, and shipping links
- Facing a chronic shortage of skilled labor at home, Taiwanese companies are eager to take advantage of the mainland's growing pool of trained engineers

The Peril

- As the economies of Taiwan and the mainland become increasingly entwined, the Taiwanese risk losing control of both their political and economic destiny
- With more and more industries moving their production across the strait to China, unemployment in Taiwan, already at a record high, will only worsen
- By seeking to forge close ties with the mainland, Taiwan risks alienating the Bush Administration, which in recent weeks has tilted away from Beijing



The criticism seems to be getting through. Breaking with Democratic Progressive Party stalwarts, Chen is starting to acknowledge that a shift in the relationship with China is essential. "Cross-strait economic policies," the President said recently, "must be constantly reevaluated and adjusted." In January, Chen called for greater economic integration. He even suggested eventual political integration, angering his independence-minded allies. On May 28, Chen's government announced it was liberalizing rules limiting how much money companies can raise overseas and invest in China. "There's no other way," says Wang Heh-song, chief economist at the state-owned International Commercial Bank of China (ICBC) in Taipei. "Everyone knows where they must go. They have no choice."

As it is drawn further into the mainland orbit, Taiwan's economy will be dramatically transformed. Most technocrats expect the island to become more like Hong Kong. It is a useful comparison. After losing its manufacturing to Guangdong province in the 1980s, Hong Kong became stronger than ever by morphing into the service hub for the Pearl River Delta. Now Taiwan has the chance to play a similar role for the Yangtze River Delta and elsewhere in China, providing banking, logistics, marketing, and research and development for local companies that do most of their manufacturing in China. "Many American and other multinational companies view Taiwan as a preferred location for launching their

business on the mainland," says Peter Banko, president of the American Chamber of Commerce in Taipei and Taiwan country manager of Bank of America.

Not that a closer economic relationship is risk-free. Taiwan could become beholden to China. "The more Taiwan invests in the mainland, the more restrained its actions will be," says Shen Dingli, a security analyst at Shanghai's Fudan University. The shift of factories to China will throw thousands of Taiwanese out of work. Unemployment is already at a two-decade high of 4%, but may be as high as 6% because of underreporting. Even as things stand now, mainland competition is hurting the cement, shipbuilding, and petrochemical industries. Suppliers to the electronics

Taiwanese execs have been navigating the political shoals for years, bending any rule that would bend

may discourage improved ties with the mainland just to push forward its own more aggressive policy toward China.

Still, Chen is under enormous pressure at home. Exports have plunged, falling 10% in April alone, and gross domestic product growth fell to 1% during the first quarter, the slowest pace in almost 30 years. To be sure, Chen's policymaking ability is being sabotaged by a legislature dominated by the opposition Kuomintang. But executives say Chen must shoulder the blame. "If Taiwan is like a big company, then Chen is not so good as the CEO," says Way-zen Chen, who is chairman of software maker Ulead Systems Inc. (and no relation to the President). "The goals aren't clear, and the management team isn't experienced."

merica, only exacerbated tensions. Yet never before has the economic relationship with China loomed so large in Taiwan's calculus. No longer can Taipei credibly tell execs to look elsewhere for business opportunities. "All our future growth depends on the mainland," declares C.Y. Kao, CEO of conglomerate Uni-President Group, which has invested \$1.5 billion in China and hopes to list some of its subsidiaries on its bourses. Kao is calling on Chen to scrap the long-standing "go slow, be patient" policy that caps mainland investments at \$50 million apiece and bans anything Taipei deems too high-tech.

HOT SPOT. To remove these restrictions and open trade, transportation, and communication links would be a reversal of epochal proportions, not to mention a political risk for a President who once led Taiwan's pro-independence forces. The clamor to tear down all barriers is putting Chen in a tight spot: He must more tightly mesh the two economies without losing control of Taiwan's destiny. He must also be mindful of relations with the Bush Administration. Some in Taiwan think the U.S.

industry are feeling the pain, too.

Nonetheless, the process is probably too far along to reverse now. Even as the Chen government steps gingerly, Taiwanese executives are deepening their business dealings on the mainland. They have been doing so for years, of course, shrewdly navigating the political shoals. Because much of the investment flows through Hong Kong or tax havens like the British Virgin Islands, no one knows just how much money has crossed the strait. According to Beijing, Taiwan companies have pledged more than \$48 billion in the mainland over the past 10 years; Taiwan officials reckon the figure is closer to \$70 billion.

During the early 1990s, much of the money went into such labor-intensive industries as textiles and toys. Higher-end industries weren't allowed to set up on the mainland, though some companies found loopholes and eventually forced Taipei to loosen the rules. In fact, market conditions forced it to: By the late 1990s, with computer makers facing shrinking margins for desktop PCs, the industry's survival depended on getting the government nod to shift operations to China. Pretty soon, the exodus was on. Today, according to Wang Jianming of Beijing's Chinese Academy of Social Sciences (CASS), 40% of Taiwan's hardware production—computers, parts, and peripherals—is made on the mainland.

CUSTOMER SERVICE? Now, despite legal restrictions on capital-intensive investment, chipmakers and designers are making the leap, too. As before, they are bending the rules to do so. Winston Wong, son of the founder of Formosa Plastics Corp., is building a chip-fabrication plant in Shanghai, though he insists his Taiwanese company has not directly invested in the project. Chip-design companies insist China engineers are engaged in customer service—which Taipei allows. In

fact, some are designing chips.

It's no wonder Taiwan's chipmakers and designers are impatient to move operations to the mainland. They need to be closer to their multinational customers. Consider chip designer Sunplus Technology Co. More than 80% of its customers, among them toymakers Hasbro Inc. and Mattel Inc., operate plants in China. Yet because of the restrictions, Sunplus risks losing business to other Asian rivals. Moreover, faced with a shortage of skilled labor at home, Taiwanese companies covet well-trained mainland engineers.

Still, even as Taiwan's economic links with China solidify, the attendant risks are giving the Chen Administration pause. As high-end electronics manufacturing and R&D move to the mainland, Taipei will be hard-pressed to replace them, and unem-

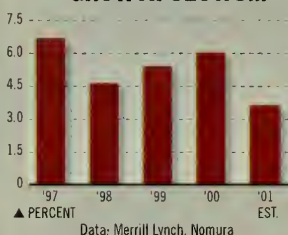
ployment will surge anew. Becoming more dependent on China also raises the probability that Beijing will use Taiwanese investors to wrest political concessions from Taipei. Already, executives close to Chen say they've been subjected to harassment. "China uses one hand to attract investment, the other to threaten,"

says Wu Rong-I, president of the Taiwan Institute of Economic Research.

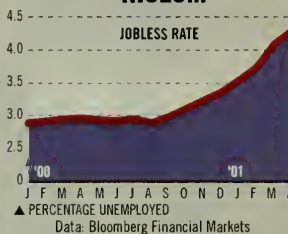
SMALL LEAP

Even Chen has called for more economic integration

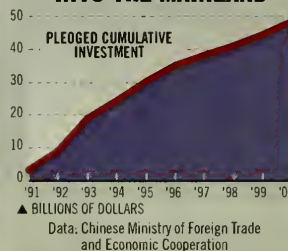
AS TAIWAN'S GDP GROWTH SLOWS...



...AND UNEMPLOYMENT RISES...



...IT'S POURING MONEY INTO THE MAINLAND



lem." At the same time, Beijing is eager to tap Taiwanese technological skill, management, and capital to help it meet ambitious technological aspirations, including plans to develop world-class semiconductor and biotech industries.

For Chen, a year into a four-year term, a breakthrough can't come soon enough. His increasingly unpopular party faces legislative elections in December that are expected to result in a coalition government with the opposition, which favors greater economic ties with the mainland. "Voter resentment is high," says Tim Ting, chief consultant at Gallup Taiwan. "Chen has to play the mainland card." If he doesn't, Taiwanese executives will.

By Dexter Roberts and Bruce Horn in Taipei, with Alysha Webb in Shanghai

BusinessWeek online

For more on Taiwan-China economic ties, go to the June 11 issue at www.businessweek.com.



Small business loans are available through the Small Business Administration (SBA) and the Federal Reserve Bank. The SBA provides loans to small businesses through its Small Business Lending Program. The Federal Reserve Bank provides loans to small businesses through its Small Business Lending Program. The SBA also provides loans to small businesses through its Small Business Lending Program. The Federal Reserve Bank also provides loans to small businesses through its Small Business Lending Program.



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national
interests are
identical with
European
interests”**

—GERHARD
SCHRÖDER,
Chancellor of
Germany

GERMANY

‘THERE’S REALLY NO REASON TO WORRY ABOUT... THE EURO’

Gerhard Schröder discusses the EU, the U.S., and Germany

Europe's economy is slowing fast, its currency is near an all-time low, and its multinationals are putting much of their new investment in the U.S. Germany and France are at odds over the future development of the European Union, and unemployment is starting to rise again. But in his spartan office at the Bundestag in Berlin, German's Social Democratic Chancellor Gerhard Schröder is anything but downbeat. In a wide-ranging interview with BusinessWeek's Frankfurt Bureau Chief Jack Ewing and European Economic Correspondent David Fairlamb, Schröder confidently asserted that the German economy is fundamentally sound. He downplayed talk of a rift with French Prime Minister Lionel Jospin, who is calling for the creation of a much more socialized Europe than the Germans envision.

On the domestic front, economists say Germany could revitalize its slowing economy and create jobs by embracing structural reform and liberalizing the labor market. But it's clear Schröder—known as an opportunist and a pragmatist—has no intention of tackling such sensitive issues this side of the 2002 general election. He isn't going to alienate the unions before then.

Will Europe in the future be a market open to competition, or will it be managed and socialized, as French Premier Lionel Jospin clearly wants?

There's no conflict between the social-welfare state and open markets. Germany is very free-trade oriented.

That has nothing to do with the question of offering people security not only in old age, but also in times when they're out of work. A market that's as open as possible is the precondition for a successful economy, and a successful economy is the precondition to being able to pay for social security. Where the limits lie is something that must always be debated, that's clear.

You've put through many reforms in the last three years. What do you still want to accomplish and how quickly?

We made two important strategic decisions: tax reform and the creation of the second pillar in the pension system, based on capital investment. That issue has been neglected for decades in Germany, and we confronted it. Next, we will create a modern immigration law.

Do you see any need to make Germany more attractive for foreign investors?

We were very unattractive. But that has changed because of tax reform. We are seeing significant growth in foreign investment in Germany. We have to better explain the positive side of codetermination [in which shareholders and employees are represented almost equally on companies' supervisory boards]. The [system], especially when a company is in crisis, has an extraordinarily important and stabilizing effect. But it looks different when viewed from outside. The same problem exists when one speaks of labor-market flexibility.

How is your relationship with President Bush?

We have telephoned several times [and] met in March. I found him to be very open and well-informed person. What I found to be very pleasant was that when there are differences of opinion—for example regarding the Kyoto accord—he speaks about these just openly as when we agree. The points of agreement are far more numerous than the differences of opinion, by the way.

As far as missile defense is concerned, a very thorough consultation process is underway. The question of feasibility, the question of cost, the question of including partners elsewhere in the world, the question of the effect of this project on arms agreements—all these issues are in discussion. One effect could be that the huge atomic arsenal created in the cold war could be reduced significantly. But it would be premature to make conclusions at this point.

The euro is near its lowest point ever. Is there a relationship between the euro



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and Europe's form of government?

We made a decision that monetary policy will be made by an independent European Central Bank. Any debate among politicians about monetary policy is counterproductive. When one looks at the prospering European economy, there's really no reason to worry about the stability of the euro. The economic power that stands behind this currency is huge. A common currency imposes on us a duty to cooperate more on policy. Indeed, the creators of the euro envisioned it as an instrument to promote political union. Whatever the details of union may be, there's no doubt we need more policy coordination in Europe.

In France and some other countries, there is fear that Germany will dominate Europe.

Germany is in favor of integration precisely because we don't want dominance. Naturally we are aware of the strength of our economy and naturally we don't want to downplay it. Why should we? We really believe our national interests are identical with European interests. And because that's so, we're fighting for more integration in Europe. No one must fear political dominance.

Unemployment has begun to climb again. Does that worry you?

Any degree of unemployment worries me. It must. Our goal is to reduce the number of unemployed in Germany to 3.5 million [from 3.87 million in April] by the end of the legislative session [in summer 2002]. The prospects to achieve that goal are still good. We want to change the way we help unemployed people find jobs. We want to be faster and more goal oriented.

Does that mean you'll put more pressure on unemployed people to find work?

We want to encourage those who are able to work, no question. To those who say, "We could work, we have the qualifications, but we don't want to,"...we want to say that solidarity isn't a one-way street.

How is your relationship with Russian President Putin, and do you believe Russia can be integrated into a security pact with Europe and the U.S.?

If I correctly understand the goal of American policy, one wishes Russia to be a partner. My impression is that American policy speaks not of antagonism but rather partnership. As far as my relationship with President Putin is concerned, it's fine.

OIL

BP TO WASHINGTON: TIME'S UP

It seems unwilling to wait any longer for a deal with Iran

It's one of the great prizes of the oil industry: the vast oil and natural gas wealth of Iran. John Browne, one of the most competitive petrobosses going, wants his piece of the action. Browne's company, BP, is sending clear signals that it wants a deal soon with Tehran, whatever the state of relations between Washington and the Islamic regime. Indeed, sources say Brown is considering projects that could add up to \$10 billion.

Browne has had to sit enviously on the sidelines as his European rivals

was unacceptable for Shell and Total have access to Iran while BP was held back by its American interests. As were BP to invest in Iran, Browne implied that it would be unfair for the company to be hit with penalties while Shell and Total continue to operate in the Islamic Republic without sanctions. Under ILSA, the British-based company could be sanctioned. But so could TotalFina and Shell—and the U.S. has not moved to slap sanctions on those companies.

BP will likely enter Iran if it finds the

right deal. It now eyeing several Iranian projects, the most important of which is probably an oil field at Ahvaz-Bangest. The Iranians may choose foreign partners soon. BP is mulling a petrochemical project and is sinking money into a joint-venture lubrication plant, which is sanctionable under ILSA. BP will build a mixing plant; Iranians will supply the oil; and the lubricants will be marketed under the Castrol label.

If BP lands

major Iranian deal, it could put pressure on the Bush Administration to rethink its sanctions against the Iranian state. For now, analysts expect ILSA to be renewed before it expires this summer and that the Presidential order against investment in Iran will remain in force. But a BP presence in Iran would drive the likes of Exxon Mobil Corp. and Chevron Corp. crazy. BP, after all, is essentially a half-American company. The oil lobby may thus intensify its push to get sanctions lifted.

Browne, in any case, will not lose sight of his goal. Iran is sure to be a key hydrocarbon region in the 21st century, he's looking hard for a way in.

By Stanley Reed in Tehran



CASPIAN SEA RIG

TotalFinaElf and, more recently, Royal/Dutch Shell Group, signed major Iranian deals. TotalFinaElf currently has four projects worth more than \$3 billion, while Royal/Dutch Shell has launched a project worth \$800 million. Browne focused his efforts on North America—buying Amoco in 1998 and Arco in 1999. Before these mergers were wrapped up, he dared not roil Washington by dealing with Iran, one of the nations long targeted for sanctions under the Iran Libya Sanctions Act (ILSA) for its alleged involvement in terrorist activities.

But with the two American companies safely in the bag, Browne no longer feels such restraint. Sources close to BP say Browne recently told Vice-President Dick Cheney, who was reviewing U.S. energy policy, that BP had been more than generous in waiting for the situation between the U.S. and Iran to improve. According to sources, Browne said that it

BP has watched its European rivals get the early jump in Iran

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EDITED BY ROSE BRADY

U. S. FOREIGN POLICY: POWELL IS STEERING TOWARD THE MIDDLE

Who will steer the Bush Administration's foreign policy? That has been the question floating around diplomatic circles in Washington and foreign capitals ever since President Bush named a team of heavy hitters. Few expected well-known hard-liners such as Defense Secretary Donald H. Rumsfeld and Vice-President Dick Cheney to see totally eye to eye with the more moderate former general, Secretary of State Colin L. Powell. As the Administration took a tough line on everything from China to the Kyoto protocol on greenhouse gases, it looked like Rumsfeld and Cheney had the upper hand.

But now, Powell is emerging as a pragmatic counterweight to his more ideological colleagues. And he is clearly scoring more points within the Administration as it comes face to face with foreign policy crises and challenges on an almost daily basis. Many of these issues are putting President Bush's campaign rhetoric to the test. "[The Bush Administration] came out swinging in a very unilateralist way," says Michael A. McFaul, a senior associate at the Carnegie Endowment for International Peace. "They have now moved away from that."

COMPLEX. To be sure, the relationship between Powell and Rumsfeld is far more complex than outsiders might assume. It is not a simple case of rivalry. For example, they both believe that nuclear proliferation is one of the key problems facing the U.S. And Powell supports Rumsfeld's overall vision of building a defense system to protect the U.S. from rogue states or accidentally launched nuclear missiles. Moreover, Powell's Deputy Secretary of State, Richard L. Armitage, is close both personally and politically to Rumsfeld's Deputy Secretary of Defense, Paul D. Wolfowitz. They share similar views on Asia policy, for example.

Still, Powell has used his diplomatic and bureaucratic skills

to pull the Administration's position toward the center on several key matters in recent weeks. Powell has taken the lead in bolstering American involvement in the deepening Middle East crisis, despite Bush's often stated views that he prefers to let the Israelis and Palestinians find their own way out of the mess. As violence has mounted again in the Balkans, Powell has argued for keeping American GIS and NATO forces on the ground—despite calls by Bush aides during the campaign and more recently that the U.S. should pull out. "We went into this together, and we'll come out together," Powell said after a NATO meeting in Budapest on May 29. And Powell jumped in front on Iraq policy, pushing for scaled-back economic sanctions that could be more acceptable to allies than comprehensive trade curbs. Says a Bush insider: "All administrations have to adjust to reality. Powell has good antennas for what reality is."

Powell's pragmatic instincts may come to serve the Administration best in its efforts to persuade its allies and Russia to accept U.S. missile defense plans. Leaders from Tokyo to Moscow to Berlin have expressed concern that Washington's abrogation of the Anti-Ballistic Missile Treaty



POWELL IN MALI: *Pragmatic approach*

which limits defensive weapons systems and has kept the peace clear. Rumsfeld would be happy to do just that and pave the way for missile defense. But Powell, backed by Armitage, is likely to seek a way to address the allies' and Russia's concerns. One option: formal negotiations to amend the pact while the U.S. proceeds with missile tests.

In the end, both Rumsfeld and Powell are likely to notch victories as they forge the Administration's foreign policy. President Bush just may need an ideologue's vision—and a pragmatist's diplomatic skills—to push his agenda on the world stage.

By Stan Crook in Washington

GLOBAL WRAPUP

CRACKING DOWN IN FRANCE

► Prison sentences handed down on May 30 to the four prominent defendants in France's most important bribery trial are another sign that an anticorruption drive is shaking up the highest levels of the once largely untouchable political Establishment. Among those found guilty in the case involving massive influence-peddling in the early 1990s by then state-controlled Elf Aquitaine is former Foreign Minister Roland Dumas, who got 30 months. Investigations into several other

bigwigs are continuing. For the moment, though, it looks as though neo-Gaullist President Jacques Chirac will escape impeachment on corruption charges. Moves by a dissident group of Socialist Party lawmakers to begin an impeachment inquiry were quashed in mid-May by the Socialist leadership. The speculation: both left and right worry about how far the probe will go.

SHAKING UP GAZPROM

► Will Gazprom's new chief be able to clean up the sprawling, state-controlled company? Alexei Miller, 39, was

made CEO on May 30 after Gazprom's board kicked longtime chief executive Rem Vyakhirev upstairs, naming him chairman. The moves marked President Vladimir V. Putin's first clear steps toward reestablishing order at Gazprom, where Vyakhirev and other managers have long blocked liberalization efforts. Miller, a Kremlin loyalist, is expected to shake up management. But he may have his work cut out for it: the powerful Vyakhirev interferes. Gazprom, 38% state-controlled, accounts for 8% of Russia's gross domestic product.

The

STARS of EUROPE

From the rapid transformation of Europe's industrial companies and financial institutions to an exploding constitutional debate about the region's political future, this is a defining moment for Europe. Call it the European experiment—the cumulative moves under way that are transforming the idea of greater European unity into a political, economic, cultural, and even military reality. Until recently, the laboratory conditions for this great experiment—Europe's new currency, greater political cohesion, and an expansion of Europe to the former Eastern blocs—seemed ideal. Economic growth was buoyant; the markets increasingly confident. Now, it's clear the challenges will be much more daunting. Growth is stalling, while the European scourge of inflation is roaring back to a level not seen for a decade.

If Europe has been spared the worst of the American dot-com implosion, it has been held up by technology problems. Billions are being spent on a push into third-generation wireless technology—just as a crisis of confidence is hitting the sector.

Yet the quest to forge a stronger European unity and identity goes on. *BusinessWeek* has identified 50 people it believes are some of the key players in this grand experiment. They range from scientific pioneers such as Novartis' Alex Matter, whose team of scientists discovered a new drug to combat leukemia, to Nicole Notat, one of France's most influential labor leaders. All of these leaders are listed here and featured on *BusinessWeek* Online. Profiles of 15 of them are in the pages that follow. They are this year's Stars of Europe, and they show how much progress Europe is making on so many fronts.

By John Rossant, with bureau reports

BusinessWeek online

For interviews with Europe's Stars and a close look at some of the companies they run, go to the June 11 issue at www.businessweek.com

INNOVATORS

ALEX MATTER	Head of Oncology Research, Novartis	Switzerland
TOM BLUNDELL	Co-founder, Astex Technology	Britain
JOHANNES POULSEN	Managing Director, Vestas Wind Systems	Denmark
FERDINAND PANIK	Head of Fuel-Cell Project, DaimlerChrysler	Germany
REM KOOLHAAS	Architect, Office for Metropolitan Architecture	Netherlands
MARC VEYRAT	Chef, Restaurateur	France

AGENDA SETTERS

GERHARD SCHRODER	Chancellor	Germany
GORDON BROWN	Chancellor of the Exchequer	Britain
NICOLE NOTAT	Labor Leader, CFDT	France
RENATE KUNAST	Agriculture Minister	Germany
MART LAAR	Prime Minister	Estonia
BOZIDAR DJELIC	Minister of Finance & Economy	Serbia
JAIME MAYOR OREJA	Opposition Leader, Basque Parliament	Spain
YASMINA REZA	Playwright, Actress	France
ANDRZEJ OLECHOWSKI	Leader, Civic Platform	Poland
DIDIER REYNERS	Finance Minister	Belgium
PAUL SPIEGEL	President, Central Council of Jews	Germany
GIULIO TREMONTI	Finance Minister	Italy

FINANCIERS

JEAN-FRANCOIS THEODORE	Chairman & Chief Executive, Euronext	France
ANTON VAN ROSSUM	Chief Executive, Fortis	Belgium
RICHARD SHIRREFS	CFO, Eurotunnel	Britain
ALESSANDRO PROFUMO	Chief Executive, Unicredit	Italy
HENNING SCHULTE-NOELLE	Chief Executive, Allianz	Germany
DAVID DE ROTHSCHILD	Chairman, Rothschild & Cie. Banque	France
FRED GOODWIN	Chief Executive, Royal Bank of Scotland	Britain
ANDRAS SIMOR	Chairman, Budapest Stock Exchange	Hungary
BERNHARD TERMUHLN	Chief Executive, MLP	Germany

ENTREPRENEURS

WANDA RAPACZYNSKI	President, Agora	Poland
JAN STENBECK	Chairman of the Board, Kinnevik	Sweden
MARIO MORETTI POLEGATO	Chief Executive, Geox	Italy
STELIOS HAJI-IOANNOU	Founder and Chairman, EasyGroup	Britain
VINCENT BOLLORE	Chief Executive, Bolloré	France
MICHAEL SCHUMACHER	Driver, Ferrari Formula One racing team	Germany
ARMANCIO ORTEGA	Chairman, Inditex	Spain

VALUE CREATORS

PETER BRABECK-LETMATHE	Chief Executive, Nestlé	Switzerland
JEAN-MARIE MESSIER	Chief Executive, Vivendi Universal	France
MATTI ALAHUHTA	Head, Cell-Phone Unit, Nokia	Finland
JOHN LEAHY	Chief Commercial Officer, Airbus Industrie	France
JEAN-MARTIN FOLZ	Chief Executive, Peugeot Citroën	France
DONAL GEANEY	Chairman, Elan	Ireland
TIM BEVAN & ERIC FELLNER	Co-Chairmen, Working Title	Britain
THIERRY DESMAREST	Chairman, TotalFinaElf	France
JEAN-PIERRE GARNIER	Chief Executive, SmithKlineGlaxo	Britain

SURVIVORS

ULRICH SCHUMACHER	Chief Executive, Infineon Technologies	Germany
MICHAEL TRESCHOW	Chief Executive, Electrolux	Sweden
THIERRY BRETON	President, Thomson Multimedia	France
NIALL FITZGERALD	Co-Chief Executive, Unilever Group	Britain
GIANLUCA DETTORI	Chief Executive, Vitaminic	Italy
JURGEN WEBER	Chief Executive, Lufthansa	Germany
DOMINIQUE HERIARD DUBREUIL	Chairman, Rémy Cointreau	France



ALEX MATTER

Head of Oncology Research,
Novartis

Inspired by the likes of Louis Pasteur and Marie Curie, Alex Matter was only 12 years old when he began dreaming that he, too, would one day be involved in the discovery of important new medicines. But the Swiss scientist, who heads oncology research at Basel drugmaker Novartis, never imagined that nearly half a century later he would make one of the most important contributions to date in cancer research.

Matter, 61, and his team of 300 scientists discovered Glivec, the first oral drug shown to be effective in the treatment of chronic myeloid leukemia (CML). The drug astounded researchers in its first clinical trials in June, 1998, when all 31 patients involved in the study went into remission. Its performance is inspiring huge expectations in the scientific community. "Our hope," says Matter, "is to turn cancer into a chronic and treatable disease."

As a result of the 1998 trial, Novartis poured millions into further re-

search and development. Just 32 months after the first clinical trials, Glivec has filed for approval with global regulators and is expected to hit the market sometime this summer. The drug, which will be marketed in the U.S. as Gleevec, was approved on May 10 by the U.S. Food & Drug Administration for use in the treatment of CML. It is awaiting approval in Europe, Japan, Canada, and Australia. The speed of development is all the more impressive considering most drugs take about seven years from testing to market. Now, doctors are testing its efficacy on certain types of cancerous tumors. So far, the results are promising: A significant percentage of patients with growths known as gastrointestinal stromal tumors, for instance, have seen their tumors shrink or even disappear.

For Matter, Glivec is the result of decades of painstaking and often frustrating oncology research. After receiving an M.D. and PhD from the Universities of Basel and Geneva, Matter did immunology and pathology research in Britain, France, and the U.S. before entering the pharmaceutical industry. Time and again, oncology researchers such as Matter thought they were close to finding a cure for cancer. "At each stage of research we made a

little more progress, but years without any breakthrough, disillusion would set in," he recalls.

Matter and his team made important strides toward a breakthrough in 1990, however. They discovered a promising new compound that they thought would inhibit the protein associated with the growth of CML. Their excitement was tempered by the knowledge that, at any point of the testing, their promising new molecule might fail. "We always told ourselves that one must work or every day we knew about the discovery and cancer biology is written," Matter says. "Failure would have been a catastrophe." In 1998, at the beginning of clinical trials, their patience was rewarded. The researchers discovered that Glivec, given at low doses, dramatically reduced cancer cells in the handful of leukemia patients very early in testing. "That was the moment of revelation," recalls Matter. "Any and all doubts about the drug's efficacy were swept away."

Glivec's success is all the more poignant for Matter, who lost a friend and fellow scientist to CML years ago. "We are far from a cure for cancer, but clearly we are making progress," he says. These days, he is interested in exploring how natural compounds, such as fungi and plants, can be used to develop new cancer drugs. A promising compound in early stages of testing is called Epithilone B, a fungus that is proving effective in interrupting cellular growth—a process that can ultimately kill tumor cells. Altogether, under Matter's guidance, Novartis has ten cancer compounds under development and will launch three new oncology treatments this year. "It's a big change from just five years ago when it was virtually nowhere in the oncology treatment field."

Matter's free time is increasingly limited these days as Novartis pushes out all the stops to build its oncology franchise. But the Basel native says that his work is so rewarding that he doesn't mind the long hours. On rare days out of the lab, the father of four enjoys mountaineering. No wonder even the Alps must seem surmountable these days.

REMY KOOLHAAS

itect and Designer,
e for Metropolitan
itecture

r the city of Seattle, Dutch architect Rem Koolhaas has created a public library for the Informa-Age—a collection of glass-enclosed es. Prada, the Milan fashion es, has signed up Koolhaas to de-torres in New York, Los Angeles, San Francisco that, he promises, ook more like conceptual art in-tions than retail outlets.

olhaas has never been so—well, His latest marriage of kitsch and Koolhaas' firm is designing an ition space for the Venetian Casi-Las Vegas, of gondola fame. The will be shared by New York's enheim Museum and St. Peters-hermitage.

57-year-old Koolhaas—tall, lean, dressed in black—seems to be where. Probably nobody else broker such a marriage of high ure commerce, and low culture. ppreciation for the exuberance of lism rivals that of Andy Warhol. ness Koolhaas' 1995 book, *S, M, L*, (authored with graphic-design Bruce Mau). Its 1,346 pages of



provocative images—which contrast his work with porno-film stills, for example—have become a required coffee-table accessory of the design elite. No activity of modern consumerism is deemed too trivial for his consideration: With Harvard University students, Koolhaas recently completed a study

of shopping, which, he says, is reshaping architecture.

Koolhaas wasn't always so ubiquitous. Critics used to say that he was a thinker, not a builder. Among cognoscenti, his books shook up contemporary ideas about urban life and architecture. But for years, Koolhaas didn't produce much in the way of bricks and mortar.

That began to change in the late 1980s, when Koolhaas' Office for Metropolitan Architecture in Rotterdam completed projects ranging from a housing complex in Japan to a villa in Bordeaux for a disabled client—in which an entire room moves from floor to floor.

Today, Koolhaas is Europe's most influential architect and an inspiration to an entire generation of young Dutch working in the profession. It was Koolhaas' role as inspirational figure, not just designer and writer, that last year won him the Pritzker Architecture Prize, the field's most prestigious. That puts Koolhaas in a pantheon that includes the likes of I.M. Pei. But has Pei been to Vegas?

DINAND PANIK

of Fuel-Cell Project,
lerChrysler

ong DaimlerChrysler's executives, few stand it as being obsessed the environment. But and Panik, a trim, 58-old engineer, is an ex-n. Having worked sev-ars for Mercedes-Benz crowded Brazilian city Paulo, he's convinced he auto industry must up its act. "If we don't nothing about energy d traffic" in developing ets such as Brazil, create a big problem hem—and for the " he says.

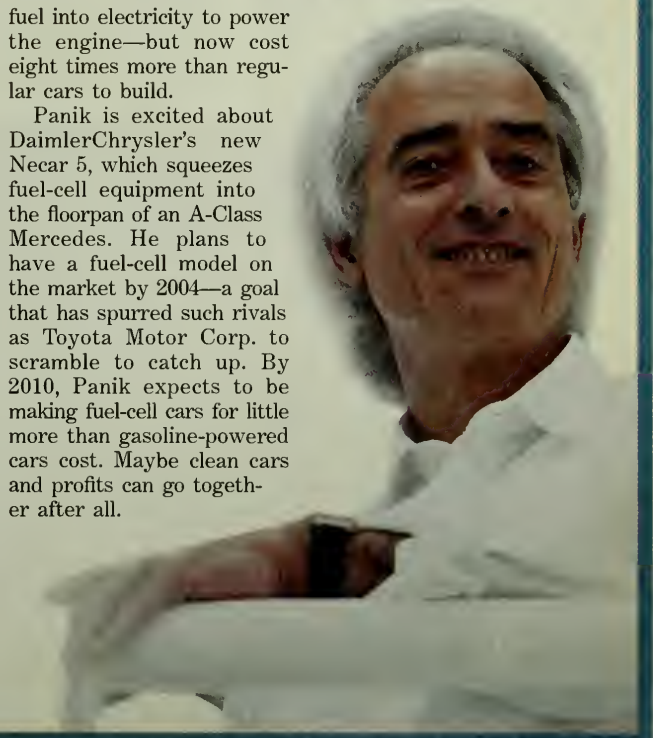
ik has found his niche id of Daimler's \$1 bil-el-cell car project, the advanced effort in eco-

logically clean autos anywhere. In 1997, when DaimlerChrysler became the first company to announce plans to turn its research project into a commercially viable business, Panik was put in charge. Trained as an electrical engineer, he had worked in Brazil in truck and bus development, and for 16 years in Daimler's vehicle research department in Stuttgart, becoming its director in 1983.

Despite technological challenges, Panik is optimistic about being able to produce fuel-cell autos economically. "It's almost within our grasp," he says. Fuel-cell cars convert hydrogen-rich

fuel into electricity to power the engine—but now cost eight times more than regular cars to build.

Panik is excited about DaimlerChrysler's new Necar 5, which squeezes fuel-cell equipment into the floorpan of an A-Class Mercedes. He plans to have a fuel-cell model on the market by 2004—a goal that has spurred such rivals as Toyota Motor Corp. to scramble to catch up. By 2010, Panik expects to be making fuel-cell cars for little more than gasoline-powered cars cost. Maybe clean cars and profits can go together after all.



TOP: KOOLHAAS BY PETER BLOK/HOLLANDSE HOOGTE; ANDREAS POHLMANN

JEAN-FRANÇOIS THÉODORE

Chairman and Chief Executive,
Euronext

Jean-François Théodore, boss of the Paris Bourse, looked like the loser when Deutsche Börse and the London Stock Exchange announced plans to marry last year. But the deal collapsed, and now, in an unexpected twist, Théodore has emerged as the only European exchange exec to pull off a cross-border bourse merger: Euronext was formed last fall from the Paris, Amsterdam, and Brussels exchanges. And now Théodore is taking his baby public, with a planned share offering this summer that could value Euronext at nearly \$3 billion, fattening its purse for future expansion. "We have the technology and the base, and we intend to stay at the forefront of this industry," Théodore says.

With a low-key style that masks fierce determination, Théodore, 54, has made Euronext a major force in the push to consolidate Europe's financial markets. His three-way merger adds up to equity trading volume of more than \$1.5 trillion annually, far more than either the German or London exchange. He's installing a unified system for trading, clearing, and settlement, using state-of-the-art technology that will make trading more efficient and less expensive—exactly what stock exchange customers clamor for. "He's managed to knit together three diverse markets very successfully and take the best from each," says Stephen Wilson, business development director for London-based virt-x PLC, an off-exchange trading system for institutional investors.

Théodore, an alumnus of France's elite Ecole Nationale d'Administration and a former Finance Ministry official, has been urging consolidation of Europe's balkanized stock exchanges since he became chief of the Paris Bourse in 1991. He contends that consolidation is essential if a culture of shareholding is to take root across Europe. The introduction of the euro and the advent of more sophisticated trading technology has only fueled the momentum, Théodore says. In 1998, he took part in talks to

create an alliance of European exchanges. The effort failed, and Théodore says in hindsight that it was a mistake. "We are an industry like any other," he says. "We shouldn't speak of alliances as if we are diplomats. We should speak of mergers, return on equity." Within a few years, he expects only three or four Western European stock exchanges to remain, down from 16 today.

If Théodore has his way, Euronext will be among the survivors. But the next step in its expansion could prove tricky. True, he could pick up some smaller exchanges—he's talking with Lisbon, for example. And he's looking to sign up more business for Clearnet, Euronext's wholly owned clearing subsidiary, which processes trades for 14 exchanges around the world. But Werner G. Seifert, chief executive of Deutsche Börse, also is looking for cross-border expansion and acquisitions, and he recently led an IPO that raised over \$900 million. London, the region's other heavyweight exchange, says it wants to remain independent, and rebuffed an offer from Théodore last year for

what he called a "merger of equals" with Euronext.

Théodore has some advantages over the competition, though. For example, Euronext allows listing companies to follow the securities regulations of their home countries. That issue was a sticking point in the failed Deutsche Börse-LSE deal, which raised hackles in Germany because it would have required German issuers to list under British regulations.

Some brokers have complained, however, that Euronext's trading model doesn't show the name of the counterparty on each transaction, making it difficult for market players to track the competition.

At least Théodore's affable personal style could make it easier for Euronext to seal cross-border deals: Seifert's ferocious manner has sometimes hindered the German's ambitions. Still, Théodore admits it won't be easy. "Two-century-old structures are not going to change in a day," he says, recalling that the three bourses now rolled into Euronext date as far back as the 1600s. But Théodore is set for the long haul.



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ANTON VAN ROSSUM

Chief Executive,
Fortis

Belgo-Dutch financial-services giant Fortis is known for its knack in executing one of the trickier acts in finance—selling insurance products through a bank, or bancassurance in industry jargon. Fortis owes a good bit of that success to its CEO, Anton van Rossum, former head of McKinsey & Co.'s Brussels operation, who took over as chief executive last fall. Van Rossum's big success: turning Belgium's Generale Bank, acquired in May, 1998, into a giant insurance sales operation. Fortis sold more than \$900 million of life insurance in the last quarter of last year to Generale Bank's customers, way more than the \$400 million

the bank predicted. More than one-third of the group's banking customers now buys its insurance products. Cost-cutting and sales from integrating the various parts of Fortis should add almost \$1 billion a year to revenues by 2004, twice the level originally foreseen.

The group's success has tempted others to try bancassurance. But, van Rossum notes, "It took us a long time to get there." Customers may not mind getting mortgages from insurance brokers and insurance at bank branches, but staff at these financial giants may balk. Insurance agents don't like selling loans, and bankers don't like selling policies.

Van Rossum says the cultural differences between the two groups are so great that they might as well be from different countries. As a Dutchman who's married to a Frenchwoman and has lived in Belgium for 20 years, he knows about soothing cultural friction.

To get insurers and bankers to cooperate takes persuasion, van Rossum says, and "you have to show you get better results by unifying the whole range of products and selling them through all the distribution channels."

So successful is Fortis at bancassurance that it's exporting its expertise. It launched a joint venture with Spanish savings bank La Caixa in 1992, and it established a joint bancassurance venture with Maybank, Malaysia's largest financial-services group in February.

The big question is what van Rossum will do next. One possibility is to merge with another European group.

"We'd make an attractive partner," van Rossum says. Especially for someone who appreciates the art of persuasion.



RICHARD SHIRREFS

Chief Financial Officer,
Eurotunnel

Eurotunnel, which runs the English Channel Tunnel, lost more than \$170 million in 2000. Yet Chief Financial Officer Richard Shirrefs says those losses will soon be but a memory. Shirrefs, a biology grad-turned-accountant who joined the group in 1996, has cut costs by 13% and the debtload by a fifth, to \$9.8 billion. Eurotunnel should actually break even next year. Impressed, institutional investors have now bought up much of the 44% of its equity that creditor banks have been holding.

Shirrefs, whose eclectic career includes stints at defense group AlliedSignal and British supermarket chain Tesco, says the crisis strengthened his hand: "It's less difficult to force through changes quickly," he says. Take investments. The company once had little regard for return: "I decided it was time to sweat the assets." Eurotunnel's recovery will be Shirrefs' triumph: "We'll finally have made a profit, and we'll finally have become a normal company." About time.



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WANDA RAPACZYNSKI

President,
Agora

Some days I feel like committing suicide or murder. But I'm never ever bored," confides Wanda Rapaczynski, the 54-year-old president of Polish media giant Agora. It's not easy being in the media business in Poland, where competition is tough and relatively few people read newspapers. Yet Rapaczynski, a former psychologist turned banker turned publisher, has emerged as one of Central Europe's most successful entrepreneurs over the past decade.

Rapaczynski has built Agora into one of Poland's largest companies, and the biggest media group by far. Its flagship newspaper, *Gazeta Wyborcza*, has a circulation of 465,000, more than twice its nearest rival. Agora also boasts a stable of 14 radio stations, and an Internet portal. Net profits last year topped \$40 million, 31% more than the year before. The company has consistently been one of the best performers on the Warsaw bourse since its flotation two years ago.

HOSTILE BID. Agora has grown so big since its launch in 1990 that Rapaczynski is now looking to expand abroad. "We have the money, we have the balance sheet, we have the expectations," she says. "But there are very few acquisition targets in Poland big enough to be interesting." She's already looking at radio stations elsewhere in Central Europe. She also plans to spend up to \$370 million pushing Agora into billboard advertising and television in Poland.

It was the launch of Agora that brought Rapaczynski, who had left

Poland during the Communist government's anti-Semitic campaign of 1968, back home. After stints in Italy and Sweden, she settled in the U.S. where she worked as a psychologist and then, after graduating from Yale School of Management, became head of new product development for retail banking at Citibank. In the late 1980s, several of her closest childhood friends set up *Gazeta Wyborcza*, and turned to her for advice. She initially provided it by telephone from New York. "But it became impossible for me to concentrate on two things, Agora and Citibank, at once," Rapaczynski recalls. So she

Rapaczynski also broke new ground earlier this year when she launched one of Poland's first hostile bids: She made an offer for AMS, the country's largest billboard advertising firm. The move failed. But Rapaczynski says she is still committed to moving into that market, which accounts for 9% of all Polish advertising. She also wants to move again into television. "We have to look at TV," she says. "We've got to figure out how to get in." The trouble is that Poland only has two commercial stations and, says Rapaczynski, "God only knows when they'll give out more licenses." Rapaczynski

says the next three years "will be our biggest test" because Poland's economy is stagnating and there are limited opportunities to grow by acquisitions.

One reason for Agora's sterling success to date has been its ability to hire and retain staff. The company has always had a special "community culture," says Rapaczynski. When the company listed in London and Warsaw two years ago, it gave share options to more than half of its 3,000 staff. "We have many employees worth several million dollars," says Rapaczynski, whose own fortune is reckoned at about \$30 million. "But they still work until 10



gave up the bank and moved back to Poland, where she became president of the company.

Initially, Agora focused on the newspaper. But by 1995, the company was ready to diversify. That same year, Rapaczynski took Agora into radio. Then two years later it bought a 12% stake in Canal+'s TKP television station. It sold that stake earlier this year because, says Rapaczynski, it was too small to make commercial sense.

every night," she adds.

Rapaczynski claims she is a much better cook than company president. She also says she is "a conservative, cautious person." But, given Agora's success to date, that sounds an overly modest assessment. The company has plenty of money to spend and will no doubt expand as aggressively in the future as it has in the past. That should help the quick-witted Rapaczynski stave off the boredom she dreads.



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MICHAEL SCHUMACHER

Driver,
Formula One racing team

Who's the best-paid guy in the auto business in Europe? Not Daimler-Chrysler's Jürgen E. Schrempp, not by a long shot. It's probably Michael Schumacher, 32-year-old lead driver for Ferrari's Formula One team. True, Schumacher says he earns far less than \$50 million, the amount outside estimates peg as his annual income—merchandising and endorsements included. But whatever he earns, it's a dazzling sum. His winnings may seem high for someone who never has to face angry shareholders or restructure a division. But consider this: Schumacher has led Ferrari back to its former glory, winning last year's world championship, his third in a 10-year career. The prospects are favorable for a fourth win this season.

There are many reasons why Schumacher so dominates his sport. One is certainly his unbelievable self-control,

which is often mistaken for arrogance. And he's so aggressive that opponents accuse him of dangerous and illegal racetrack moves. But when he's not circling the track,

Schumacher is known as a demon worker who heads to Ferrari's test track in Fiorano, Italy, to try out new equipment. "Formula One is not only about driving," he says.

Schumacher, a German who lives in Switzerland, is almost solely responsible for the phenomenal success of Formula One in Germany, where weekend broadcasts attract as many as 14 million people, nearly 80% of viewers between 14 and 49.

He's clearly one of the hottest names in sports merchandising. Just ask Oliver Müller, president of Atlas Design, who markets a line of Michael Schumacher neckties, boxer shorts, and other apparel. Müller hopes to generate about \$1 million in sales in two years. He has already sold \$250,000 worth just three months after launch. "People identify with him," Müller says of Schumacher, a German hero in a sport long dominated by the British.

Schumacher's skills combine those of a turnaround artist, box-office draw, and brand. And, of course, he risks his life on a weekly basis. How many CEOs can say that?

STELIOS HAJI-IOANNOU

Founder and Chairman,
EasyGroup

Stelios Haji-Ioannou speaks the language of Silicon Valley, tossing off phrases such as "frictionless Internet" without blinking. But behind the jargon is an entrepreneur who's showing Europe how to combine radically simple business models with the Net to reshape old-line industries.

Haji-Ioannou, 33, is founder and chairman of London's easy-

Group. Its holdings include easyJet Airline; easyEverything, a chain of cybercafés; and a rental car company called, naturally, easyRentacar. All rely on the Net to keep costs

low: EasyRentacar offers only one type of vehicle and requires reservations be made online.

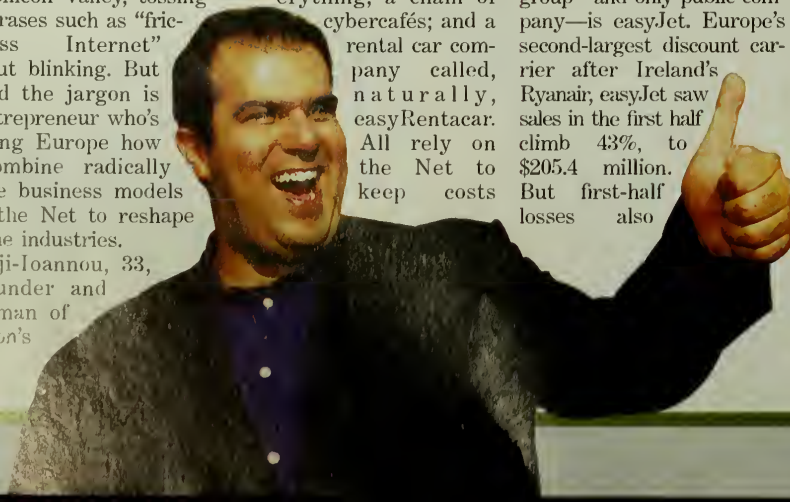
But its prices are 60% below the industry giants.

The granddaddy of the group—and only public company—is easyJet. Europe's second-largest discount carrier after Ireland's Ryanair, easyJet saw sales in the first half climb 43%, to \$205.4 million. But first-half losses also

grew, to \$14.6 million, because of higher fuel prices and slow winter traffic.

ELECTRIC ORANGE. Haji-Ioannou keeps going, though. It's nearly impossible to go anywhere in urban Europe without noticing the Easy brand: Everything Haji-Ioannou touches, from Boeing engines to billboards, is painted electric orange—Pantone 021C, to be exact. Maybe someday, he jokes, it'll be renamed "Stelios Orange."

Next stop: America. The second son of a Greek shipping tycoon, Haji-Ioannou has already anchored an easyEverything café in New York's Times Square. This is one European who's not staying in the Old World.



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PETER BRABECK

Chief Executive,
Nestlé

It wasn't the fast track. When Peter Brabeck-Letmathe joined Nestlé back in 1968, the young Austrian's first job was selling and delivering ice cream. Every morning, he would drive a freezer truck around the Alps to supermarkets and cafés. After two years, he received his first foreign assignment—in Chile, then run by a Marxist and heading toward a bloody coup d'état. Brabeck helped Nestlé's operations avoid nationalization. Later, he became manager in Venezuela and Ecuador, where he turned around a subsidiary by closing factories and laying off more than half of the staff. "I learned to manage through turmoil," he says.

Compared with these dramas, the 57-year-old Brabeck is making Swiss-style corporate restructuring look like a cakewalk. In three years as Nestlé's chief executive, he has jet-tisoned mature businesses, slashed costs, and focused investment on fast-growing fields. Margins have jumped from under 9.9% to 12.2%. The company's market capitalization has tripled, to close to \$100 billion. That's quite an achievement in a world where food prices are flat or falling, and major brands such as Coca-Cola and Kellogg are struggling. "My job," says Brabeck, "is to take an athlete who can run the 100 meters in 10 seconds and improve it to 9.8 seconds."

Nestlé's sprinting speed underscores many of Europe's corporate strengths: its ability to create multinationals that cross cultural borders and turn unspectacular-sounding products, such as bottled water and pet food, into solid profit-turners. "My actions may sound slow in Silicon Valley," Brabeck admits. "But they are fast for a company with factories in more than 80 countries and products that are sold in every country in the world—even in North Korea."

Other European food businesses, particularly Unilever and Danone, are embarked on a similar path. But Nestlé is the largest of the three, with \$47 billion in annual sales, 224,000 employees, and 8,000 brands ranging from candy bars to baby



formula. "Brabeck has taken a company that is a collection of fiefdoms and turned them into an effective, single global company," says Sylvain Massot, an analyst at Morgan Stanley Dean Witter in London.

Brabeck decided on a career with Nestlé as a path to a larger stage beyond his native Austria. "When I was growing up, career opportunities depended on your status in a political party, because 75% of the Austrian gross domestic product was state-owned," he recalls. He epitomizes Nestlé's polyglot culture. Brabeck's wife, an interior designer, is Chilean. He speaks Spanish at

home with her and their three grown children. He's also fluent in French, Italian, Portuguese, and English.

His favorite business language is discipline. When he took over Nestlé, he began selling off such slow-growth units as Findus frozen foods and Hills Brothers coffee. He focused investment in more promising fields, such as bottled water and pet food. In January, Brabeck spent \$11 billion to buy Ralston Purina Co., the leading pet-food maker in North America.

Brabeck's other strategic goal is transforming Nestlé from a set of far-flung operations into a single global machine. He has inked a \$200 million deal with SAP to link its five e-mail systems and permit Nestlé's headquarters in Vevey, Switzerland, to know for the first time how many raw materials its subsidiaries buy, in total, from around the world. The company then will be able to negotiate better contracts with suppliers and centralize production. Last year alone, Brabeck closed 38 different factories. All told, he has slashed \$1.6 billion in costs, without labor strife.

That's the man's style—not flashy, but effective. There are no dress-down days at Nestlé, and the chief executive favors dull gray suits. A broad-shouldered man with the ruddy complexion of a mountain climber, he loves hiking in the Swiss Alps, which rise just behind his office at Nestlé's headquarters. Scaling a giant like Nestlé requires a long, tough climb. But Peter Brabeck-Letmathe is turning out to be an expert mountaineer.

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outside of.



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TIM BEVAN & ERIC FELLNER

Co-Chairmen,
Working Title Films

Tim Bevan and Eric Fellner have shown the film world that it's possible to combine the words "British" and "blockbuster" without creating an oxymoron. They have done it not once, but with a string of hits, including *Notting Hill*, *Four Weddings and a Funeral*, *Bean*, and now,

Bridget Jones's Diary. The secret? Delivering fun and romantic films, preferably starring secret weapon Hugh Grant.

New Zealand-born Bevan, 43, and British-born Fellner, 41, are co-chairmen of Working Title Films, one of Europe's top production houses. Films from this London-

based company have grossed \$1.5 billion in the past decade. Its current hit, *Bridget Jones*, which stars Renée Zellweger and the floppy-haired Grant, made British box-office history in April by hitting the No.1 slot in the U.S. and Britain simultaneously.

Bevan and Fellner both started in the film business in the mid-1980s, but the two didn't begin working together until 1992. They came out with *Four Weddings*, their first blockbuster, in 1994. Another big boost came in 1999, when they struck a deal with Universal Studios in Hollywood and French TV business Canal+, both owned by French giant Vivendi Universal. Bevan and Fellner receive full studio backing and worldwide distribution for their films and can O.K. projects with budgets of up to \$25 million without even consulting Universal.

That's a strong vote of confidence in the value of their work—and yet another sign that you don't have to be American to make it big in Hollywood.

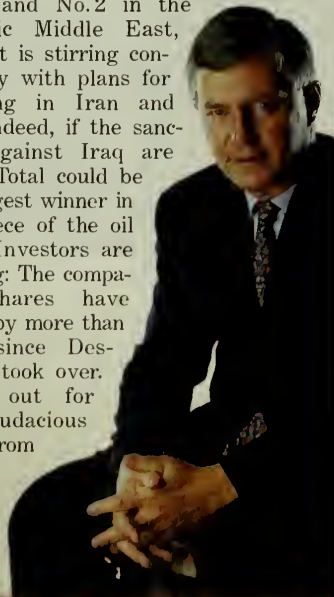
THIERRY DESMAREST

Chief Executive,
TotalFinaElf

In the decades following World War II, Big Oil was a mostly Anglo-Saxon affair. Until France's Thierry Desmarest came along, that is. Just three-and-a-half years after taking the helm of Paris-based Total in 1995, the soft-spoken but steely Desmarest, 55, showed empire-building flair with his deft \$12 billion acquisition of Belgian energy group PetroFina. Desmarest's biggest coup followed months later: his takeover in early 2000 of once-larger French oil rival Elf Aquitaine.

The moves make TotalFinaElf, with \$101 billion in sales, the No.1 oil refiner and distributor in Europe. In terms of production, the company is tops in

Africa and No.2 in the strategic Middle East, where it is stirring controversy with plans for investing in Iran and Iraq. Indeed, if the sanctions against Iraq are eased, Total could be the biggest winner in that piece of the oil patch. Investors are cheering: The company's shares have soared by more than 300% since Desmarest took over. Watch out for more audacious moves from this empire builder.



JOHN LEAHY

Chief Commercial Officer,
Airbus Industrie

What did it take for Airbus Industrie to soar from 20% to 50% of the global aircraft market? Seven years and one aggressive salesman. Since New York-born John Leahy took charge of its commercial division in 1994, Toulouse-based Airbus has logged two-thirds of the 4,200 orders in its 31-year history and pulled even with Boeing Co.

And Leahy, 50, is still gaining altitude. He's leading Airbus into the extra-large aircraft market, challenging the Boeing 747 with a bigger jet, the 555-



seat Airbus A380. Leahy has booked 62 orders for the A380. Boeing shelved plans for a stretch version of the 747, which failed to attract customers. But it has unveiled plans for a long-haul jet that will fly 10% faster than today's planes.

Leahy says Boeing's new plane won't hurt demand for the A380. He's keeping up his frenetic pace, though, traveling 200 days a year. Leahy has to sell at least 200 more A380s for Airbus to break even. For the salesman from New York, the heat is on.



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ULRICH SCHUMACHER

CEO

Infineon Technologies

After arriving at his Munich office in the morning, Ulrich Schumacher likes to pop a CD into a player on his desk and blast a track by singer James Brown. Nothing like the godfather of soul shouting "I feel good!" to get a manager psyched up for the day ahead, says Schumacher, 43, CEO of German semiconductor maker Infineon Technologies.

Lately, plenty of psyching-up has been in order. The semiconductor business is rugged in the best of times, but now it's brutal as businesses and consumers spend less on PCs, mobile phones, and other devices that run on semiconductors. Even the normally irrepressible Schumacher, who typically leaves the office at 1 a.m., concedes he can get tired. "Sometimes it's real fun," says Schumacher. "But there are times when life is not very rewarding."

Schumacher doesn't stay down for long, though. And so far, his company seems to be coping better than most. Yes, profit at the world's ninth-largest semiconductor maker is way down, plunging 84% in the quarter ended Mar. 31, to \$20 million, on sales of \$1.5 billion. Shares in Infineon, spun off from Siemens last year, are off 58% from their 12-month high. But shares of Broadcom Corp. in Irvine, Calif., which makes chips for broadband telecommunications, are down

85% after three losing quarters.

Schumacher has managed to stay in the race in part by shaking up the old-style culture at Infineon, still 71%-owned by Siemens. When Schumacher became CEO in 1996, the company—then a Siemens division—was a collection of regional fiefdoms. Schumacher reorganized it along global product lines, such as chips for telecommunications or for the auto industry. He paid more attention to shareholders, meeting regularly with analysts and fund man-

agers. He put up a stock ticker at the entrance to corporate headquarters so employees would also pay attention to the shares. It continually displays Infineon's share price in bright red letters. And he gave managers stock options.

But that's not the whole story. Schumacher isn't one to follow corporate fashion. The pundits told him to focus, and Schumacher did, up to a point. He sold the unit that made chips for entertainment products. But Schumacher refused to put all his money on one or two segments. Infineon's product range includes chips for smart cards, for cars, and for telecommunications. Infineon also makes so-called DRAM memory chips, a business that can be devastating in bad times but highly profitable in good. Now, Schumacher is forging ahead with new capacity to make memory chips based on

300-millimeter wafer technology. That will allow more chips per wafer than is now offered by any rival. "It makes no sense to cut investment and R&D in an industry that's so innovation-driven," says Schumacher.

Five weekends a year, Schumacher still races sports cars. His office is lined with trophies, but he frets: "They're all third places. That makes me nervous. Always finishing third is not exactly what I want to do in life." In business, anyway, he's determined to keep moving up.



DOMINIQUE HÉRIARD DUBREUIL

Chairman,
Rémy Cointreau

Rémy Cointreau looked ready to go down the drain—until Dominique Hériard Dubreuil took over as chairman in 1998, replacing her father. The French company was deep in debt and losing \$100 million a year as the Asian crisis sank sales of its Rémy Martin cognacs. Hériard Dubreuil, who had pursued a career in public relations while her brothers helped run the family business, seemed an unlikely candidate to revive it.

But Hériard Dubreuil has put the sparkle back into Rémy Cointreau, turning the company into a lesson in how Europe's family-run businesses can remake themselves. She sold off marginal assets

such as a Bordeaux wine-trading company, while beefing up marketing of brands such as Rémy Martin and Piper-Heidsieck Champagne. She transformed the company's distribution network into a profitable joint venture with Scotland's Highland Distillers and Jim Beam Brands of the U.S. And she acquired Bols Royal Distilleries of the Netherlands to reduce Rémy Cointreau's reliance on cognac. Profits last year soared 34%, to \$141 million, on sales of \$755 million.

Hériard Dubreuil, 54, says her 20 years advising corporate clients before joining the cognac division of the family business in 1988 helped her decide on a plan for Rémy Cointreau. The company's shares, 65% owned by the Hériard Dubreuil and Cointreau families, have doubled in the past two years. "I'm here to create value and maximize it," she says. That's something to raise a glass over.



Frequent Flyer Miles

Hard Currency for High Flyers



Frequent Flyer Miles

Hard Currency for High Flyers

Just a Matter of Miles

You've got miles. And points. And more miles. But what are you going to do with them? As loyalty programs evolve with the needs of their customers, they are trying to become more flexible. In the past, earning was easy, spending was hard. That's changing. More than 8,600 supermarkets, 50 airlines, 30 phone companies, 20 hotel chains and dozens of credit cards run loyalty programs. Used to be, these businesses would redeem only the credits you had earned with them. And sometimes that wasn't the easiest experience. But as travel has become more challenging, as travelers have become more harried, the better points plans have seen the light. They've learned to smooth the traveler's path. They're giving the customer more ways to convert, spend and benefit from miles. And in return, they're earning a lot more of what they always said they wanted from travelers — loyalty.

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- Flexibility is Key to New Non-Airline 'Miles' Plans
- Beyond a Bed and Bath
- Tech Companies Score with Travelers



Airlines Use Miles to Better Serve Program Members

When everyone offers miles, and everyone has more than they can spend, the best programs will be those that treat the customer like an individual.

With dot-coms turning into dot-bombs and the experts trying to avert an economic nosedive, frequent flyers might find themselves on the cutting edge — literally — as 2001 marches toward its midpoint. Airline consolidation, the ubiquity of marginally differentiated miles programs, and an abundance of miles earning opportunities define a marketing tool in search of a new value proposition. In short, travelers will see the travel industry evolving its loyalty programs to foster more of a true relationship with customers.

Placing a higher emphasis on customer service is precisely why Frontier Airlines, the low-fare carrier based in Denver, created its own program, EarlyReturns®, in February. It pays members free round-trip tickets after they've amassed just 15,000 miles. "We cater to the infrequent flyer, the entrepreneur, the small business owner who needs to fly occasionally," says Lowell Miller, Frontier's director

of e-commerce. "Our bottom line is to understand who our customer is today. Being able to do one-to-one marketing in a cyber world will mean success."

Up to now, service enhancements have been more broad-brush in approach, from American Airlines adding legroom throughout all its planes, to Continental expanding overhead bins, to the spread of e-kiosks that speed the check-in process. But what's that got to do with frequent flyers? Remember, miles are for everyone these days. American's AAdvantage® program, for instance, distributes more than 50 percent of its miles through partners. They dole them out for everything from car rentals to Mother's Day bouquets.



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Double Dip is a stay for which HHonors members earn both Points & Miles™ at Hilton HHonors hotels. You must be an HHonors member to Double Dip. One Double Dip stay during the promotion qualifies members to earn double miles for successive Double Dip stays. Members paying with an American Express Card can also earn double HHonors Base points for additional stays. Offer valid from 6/01/01 to 8/31/01. Hilton HHonors membership, earning of Points & Miles, and redemption of points are subject to HHonors Terms and Conditions. Online enrollment is offered through December 31, 2001. ©2001 Hilton HHonors Worldwide.

Bruce Chemel, president of AAdvantage marketing programs, says the program's goal is to give every member a chance to spend the miles they earn. "We are quite convinced that travel will always be the key award," Chemel says. "What we're trying to do is grow the value equation for as many people as possible. "Our goal is that people never lose their miles. The way to maximize the value of a program is to give people the opportunity to spend the miles they've earned."

Here's a rundown on what's up with the major frequent flyer programs.

AeroMexico (Premier®)

Residents of Mexico can earn a round-trip flight within Mexico the minute they qualify for the Platinum Card American Express® AeroMexico card. In addition to an instant 20,000 Premier miles — good for one free trip, plus a free companion ticket — cardholders earn triple miles every time they buy travel services from AeroMexico, which, by the way, is linked with the SkyTeam alliance. Club Premier members rack up 4,000 bonus miles for their first online purchase and 1,000 bonus miles for every AeroMexico buy after that. Mucho grande. For details, click through to www.aeromexico.com.

American Airlines (AAdvantage®)

Popular in the year 2000 with breakfast eaters — or their frequently flying parents — the American Dream promotion continues to give 100 AAdvantage miles to buyers of specially marked packages of Kellogg's cereals — everything from Kellogg's Corn Flakes to Kellogg's Product 19 — plus certain Nutri-Grain, Pop Tarts and Eggo waffles varieties. Redemption in groups of five coupons continues through November 30 this year. For details, see your grocery store, or call 800.962.1413.

Small to midsize businesses that want a little extra for their travel buck can get it with the Business ExtrAA program. Spend \$10,000 with American Airlines during a given quarter, and your business will earn 1,000 Business

ExtrAA points. Free travel in the U.S. begins at 2,000 points. The Business ExtrAA points accrue in addition to miles earned through the individual traveler's AAdvantage account. For details, go to www.BusinessExtrAA.com.

Continental Airlines (OnePass®)

Members of the OnePass program could be getting an upgrade, and not even know it. Continental's new Elite Upgrade Automation System considers your Elite status priority, fare status (Y fares) and time of reservation. If space is available and nobody else is in the virtual line ahead of you, the system automatically issues an upgrade to First Class. Platinum Elite members qualify first, within three days of departure. Gold Elite members qualify within two days, and Silver Elite

members at midnight on the day of departure. If you're approaching 25,000 miles in the calendar year, you could qualify. For more, go to www.continental.com.

Delta Air Lines (SkyMiles®)

Fork over the \$135 annual fee for the Delta SkyMiles Platinum American Express card, and instantly pocket 15,000 SkyMiles. Less expensive Classic and Gold cards earn 5,000 and 10,000 SkyMiles bonuses, respectively. Spend a dollar amount equal to the mileage bonus in the first six months, and double the bonus. Beyond the signup bonus miles, the cards up the ante for affinity cards; they earn two SkyMiles for every dollar spent. To apply for a card, go to www.americanexpress.com or call 800.SKYMILES.

Flexibility is Key to New Non-Airline 'Miles' Plans

How can you earn free travel if you're not a frequent flyer? Easy. Scores of companies offer airline miles, and some are creating their own generic mileage plans that can take you anywhere you want to go.

How do you like your miles? These days, you can earn them almost anywhere, and spend them on almost anything.

The best development in recent months, though, is the surge in services that let you treat your branded miles like generic miles. With every passing day, evolving mileage programs treat the customer more like a king and less like a captive. No longer slaves to Byzantine rules, limits and reward thresholds, travel consumers can pick programs that uniquely suit their needs. Then they can go to town.

"Airlines know how many miles go unclaimed," says Dean Headley, a Wichita State University marketing professor who

No longer slaves to Byzantine rules, limits and reward thresholds, travel consumers can pick programs that uniquely suit their needs.



produces an annual airline quality rating. "To them, it's found money. By selling miles to partners, they recoup their upfront costs, and anything that is

redeemed is money in the bank." A host of new businesses, however, are hoping to give travelers access to that money in the

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Not all vehicles and vehicle equipment shown are available at all locations. Use of rental vehicles off paved roads is prohibited.
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mileage bank. The willingness of program operators to open their vaults will say much about their dedication to consumer benefits.

Otherwise, spending flexibility depends on where you earn the miles. All miles earned with WebMiles, for instance, earn travel on any airline. To create those spending opportunities, WebMiles is broadening its earning opportunities. It has enlisted major retailers such as the Ralphs Grocery Company in San Diego and Smith's Food & Drug Stores in Las Vegas to complement a host of cyber stores. "Our core strategy is to offer customers as many ways as possible to earn WebMiles," says Jennifer Case, vice president of marketing. "To some extent, we're the new S&H Green Stamps."

Here are other ways you can earn miles without actually doing the miles.

BankDirect

(www.bankdirect.com)

Beyond interest and laptop access, online banking pays (ta-DA!) miles. In partnership with American's AAdvantage® program, BankDirect doles out miles to people who open checking or money market accounts, buy CDs, or sign up for direct deposit. Earn 1,000 miles for a new account, 5,000 miles for direct deposit, 2,000 miles for using bill pay and 100 miles per month for a minimum \$1,000 balance. There's more. Check it out online.

Hertz

(#1 Club Awards®)

Looking for a sweeter rental ride? With the new Hertz Prestige Collection program, Hertz customers will get an expanded selection of luxury wheels. As of June 1, selected North American airports will offer several models from such respected names as Jaguar, Land Rover, Lincoln and Volvo. Participating airports for the Phase 1 rollout include Los Angeles, Orange County, San Francisco, San Diego, Las Vegas, Dallas, Denver, Phoenix, Atlanta, Orlando, Miami, Tampa, Fort Lauderdale, West Palm Beach, Washington, D.C., Chicago and Boston. Canadian travelers can try it out in Vancouver, Montreal and Toronto.

To reward customers crossing over from its main line of Ford cars and trucks, Hertz will be offering bonus miles with airline partners and points in its #1 Club Awards® program. The program offers free pickup or return at hotels within 15 miles of a Prestige Collection rental center. All cars come equipped with the Hertz onboard NeverLost® navigational system, and a free one-year enrollment in Hertz #1 Club Gold. For details, go to www.hertz.com, or call toll-free 800-654-2250.

Diners Club

(Club Rewards®)

A longtime favorite of frequent travelers, Diners Club has rolled out a new premium card geared to the U.S.-based international traveler. The Diners Club Carte Blanche Card, in addition to points redeemable on a dollar-for-dollar basis for air travel with any carrier, confers access privileges to more than 200 top-flight golf courses

around the world. Cardholders also get a free event and gift reminder service, free entertainment planning through the VIPdesk, expanded travel insurance, interest-free borrowing for 62 days, and free two-week rental of an international cellular phone. Annual fee is \$300. To get yours, call 877.604.6723 or go to www.cartelblanchecard.com.

Neiman Marcus

(United Mileage Plus®)

Through a new partnership with the world's largest airline, Neiman Marcus has arranged for members of its InCircle Rewards program to swap points for Mileage Plus miles. Retail's first loyalty program, InCircle Rewards, credits customers with one point for each dollar spent with Neiman Marcus. Customers now can redeem 5,000 or more points for equal amounts of Mileage Plus miles. To check out program guidelines, go to www.united.com.

Beyond a Bed and Bath

Hotels just keep making your stays a little nicer, packed with more miles and points than ever.



Want that TV ergonomically placed so you can watch the news while you're working at the desk in your hotel room? Would you rather not walk on the

carpet in your bare feet? Even if you haven't given these tiny comfort items much thought, it's nice to know your hotel has. "We are fascinated by how our consumers think," says Mark Snyder,

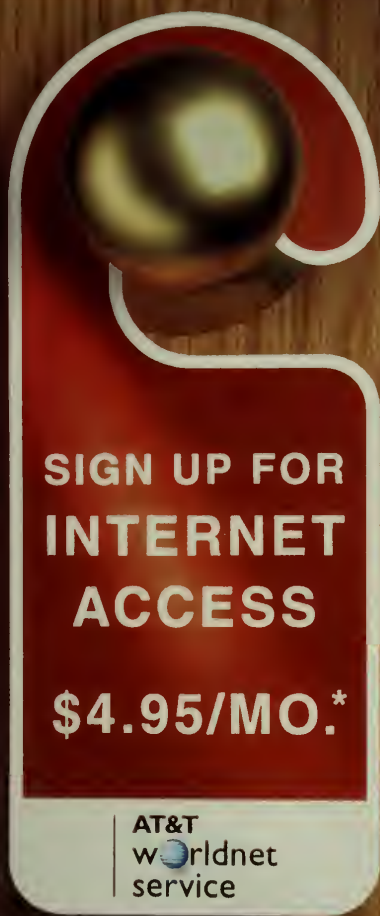
senior vice president for brand management of Embassy Suites Hotels.

A survey of more than 300 frequent travelers found two distinct types of travelers: upstairs and downstairs guests.

A survey of more than 300 frequent travelers found two distinct types of travelers: upstairs and downstairs guests. Upstairs guests prefer peace and quiet, room service and roomier accommodations. Downstairs guests are more extroverted, like to dine out, use concierge services and prefer social spaces to private

areas. Men tend to be downstairs guests and women, even extroverted women, tend to be upstairs guests.

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† Marriott Rewards bonus points awarded after two months as an AT&T WorldNet member in good standing. Bonus points offer expires 12/31/01 and is valid only in the United States.
©2001 Fairfield Inn

fine-tune its guest services, trying to fill those needs that might even be hard for guests to articulate. To create an environment where both upstairs and downstairs guests can socialize comfortably, Embassy Suites offers a two-hour evening manager's reception at all properties.

The study also showed that while upstairs personalities enjoy staying upstairs, downstairs personalities still like a little elbow room upstairs. In fact, 75 percent of the male respondents in the survey reported increased productivity while working in larger spaces. "Every hotel has a bed, a pillow and an amenity pack," says Snyder. "When you can provide for the very idiosyncratic needs of your guests, then you're getting somewhere."

Here's what your favorite hotel chain is doing to make sure your every whim is met.

Hilton Hotels HHonors®

(www.hiltonhhonors.com)

Like to go by train? Hilton HHonors members can earn up to 500 Amtrak Guest Rewards points for stays at any of more than 2,000 Hilton HHonors hotels worldwide. Plus, members can earn an additional 250 HHonors travel partner bonus points for each stay by simply showing their Amtrak boarding pass at check-in.

Buy or sell a home, and earn Hilton HHonors points two ways. Fund the loan through Countrywide Home Loans, and earn 2,500 points for every \$10,000 of the loan. Use a real estate agent in the Delta Corporate Services network, and earn an additional 2,500 points for every \$10,000 in price for the purchase or sale of a home.

Marriott Rewards®

(www.marriottrewards.com)

If a Florida golf vacation seems a tame way to use the points you earn at Marriott properties, now you can pick from nine adventure travel packages. The packages include six to ten days at exotic spots in Europe, Latin America and the United States. The trips are available through Mountain Travel

Sobek and can be booked through October 31, 2001, for travel by the end of the year. Excursions include exploring the waterfalls and wildlife of Costa Rica's rain forest.

Fairfield Inn

(www.fairfieldinn.com)

Getting a "good deal" is pretty trendy this spring. The big lodging chains are making that easy for you with lower-priced properties that still give you points in their frequent guest program. Marriott's Fairfield Inn is a good example. With 430 properties throughout the U.S., it's become a leader in the lower-moderate price category, and you get Marriott Rewards® points when you stay. You also get a free continental breakfast, pool and spa, valet laundry, exercise room, a meeting room and business services.

Starwood Preferred Guest®

(www.starwood.com)

This summer, Starwood will offer its popular Free Weekends promotion, which allows members to earn free nights fast.

Members who stay five nights at participating Starwood hotels around the world will earn two free Friday nights. Members can earn free weekends from May 15 to August 31, 2001 at participating Sheraton, Westin, Four Points by Sheraton, Luxury Collection, St. Regis and W hotels, and redeem their free nights from June 1 through September 28, 2001.

For the second consecutive year, frequent travelers have named Starwood Preferred Guest the number one hotel frequency program in the world. Starwood Preferred Guest was voted "Program of the Year" in both America and Internationally during the 13th Annual Freddie Awards in April, one of the most prestigious honors in the travel industry. Launched just two years ago, Starwood Preferred Guest also took top honors for Best Customer Service in America and Internationally; Best Award Redemption in America and Internationally; Best Elite Level in America and Internationally; and International Best Web Site.

Tech Companies Score with Travelers

From hip new wireless services to improved airport business centers, technology and frequent flyers are a match made on one of Wall Street's better days.

If you've got the dot-com blues, the techno-savvy travel industry does not feel your pain. While many e-commerce companies are finding customers a rare commodity, those serving travelers are growing. Forrester Research estimates that of the \$12.2 billion spent online in 2000, \$8 billion was spent by travelers.

Why? Well, says Stacey Spencer, spokesperson for online travel agency Orbitz, "You don't have to feel a plane



Forrester Research estimates that of the \$12.2 billion spent online in

2000, \$8 billion was spent by travelers.



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*Based on a comparison of Aeromexico's systemwide operations, derived from internal company records, and the U.S. carriers' published DOT's Weekly On-Time Performance Reports for calendar years 1990 through 1999.

ticket to *buy* it. You can see pictures of your hotel room, which is more than you got when you called on the phone." The growth is good news for business travelers itching to use their PDAs to rebook a delayed flight, or check for a hotel room en route. It also means road warriors can expect their every technology need to be taken seriously, including that practically old-fashioned interest in checking e-mail, or printing out a presentation.

"We have something you can wrap your arms around," says Dave Luck, the vice president of marketing for eKiosk, a new generation of Internet workstations. The kiosks offer ten free minutes of advertiser-sponsored Internet use, plus a variety of services including video cameras, Web phones, ports for PDAs and high-speed data ports. If your company registers, you'll be able to reach your own desktop back at the office from an eKiosk workstation. "We've rolled out 922 kiosks. Our network is doubling every two months," says Luck.

If you want to cruise into a mobile office, Laptop Lane has the answer for you. Now located in 18 airports, these cushy full-service private offices with a door include an ergonomically-designed work space, Pentium III desktop, a multi-line phone, a T-1 line, and a combo photocopier and fax machine. Each pod of four to eight offices comes with a live "cyber concierge" who actually knows how to use the equipment. Pay by the minute — about \$39 an hour — but all your domestic phone calls are free.

If you'd rather "interface" with a PDA or your computer, there are lots of options for you too:

SideStep

(www.sidestep.com)

Working as a travel intermediary, SideStep has created a browser plug-in that searches the Web sites of more than 90 different travel suppliers. When users request information about airfares, hotel rooms and car rentals, they get a simple rate comparison and — perhaps best of all — information about online booking mileage bonuses. When they see a price they like, they click through to the provider's site for booking. The virtual

computer reservation system (it doesn't use any of the legacy CRSes such as Apollo or Sabre) is designed to give travelers the utility of full-service sites like Expedia, but the added value of information about mileage incentives offered only to users of travel Web sites.

i-tinerary Travel Solutions

(www.i-tinerary.com)

It may be the ultimate gal Friday: the mTravel Assistant from i-tinerary Travel Solutions is a real-time intelligent electronic assistant. The free and downloadable service (use it on your PC or PDA) includes schedule integration, automated trip planning driven by appointments, immediate notification of trip delays or cancellations and a dozen more features. Forget those gut-wrenching moments when you're at the ticket counter and your flight's been canceled. The trip repair function informs you of the problem, and using your preferences, rebooks you.

YouPricelt.com

(www.youpriceit.com)

They may sell only 1,000 tickets a month, but the five well-seasoned travel agents behind YouPricelt.com could give you the best of both worlds if you're willing to wait for up to 24 hours to book your flight. The site lets you bid on airline tickets via its Web site, but it's real people who search — across all airlines, including low-cost carriers — for your

flight. If they can find it for you cheaper than your bid price, you get it for the cheaper price.

Orbitz

(www.orbitz.com)

Conduct a flight search on Travelocity or Expedia, and you're getting fare info that's maybe a day old. When Orbitz — owned by several major airlines — launches its fully-loaded site this month, it promises real-time availability for every possible flight. "Nobody else does this," says Orbitz's Stacey Spencer. How? It bypasses the standard computer reservation systems. Spencer dismisses questions that the service might exclude some options. "We'll show every airline, and we won't take marketing dollars for a flight to pop up first." The one drawback: the site won't show Internet-only fares.

Writer: Stuart Watson is a business travel specialist. Kathy Watson is a hospitality industry expert.

Design: Sundberg & Associates, Inc.

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Correction: In "The Cyber Traveler" Special Advertising Section in the May 7, 2001 issue, we omitted an important piece of information about Lufthansa in the "What's Up In Wireless" article. We should have stated that the program covered was available only in Germany. For information about Lufthansa, go to www.lufthansa-usa.com.

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Science & Technology

MEDICINE

ARRESTING ALZHEIMER'S

Drugs that fight milder memory loss may prevent its onset

A new front has opened in the battle against Alzheimer's disease. Coming up with a cure for this dreaded form of dementia has proven devilishly hard, since by the time victims develop Alzheimer's, their brains are usually too damaged for any treatment to do much good. So drug companies are increasingly turning their attention to a different class of patients—those who suffer from noticeable memory loss but otherwise function normally. The theory is that treating patients with this condition, known as mild cognitive impairment (MCI), might delay or deter full-blown Alzheimer's.

MCI sufferers show no deterioration in IQ scores but they experience "forgetfulness of a significant nature," such as failing to recall conversations held a short time before, says Dr. Ronald C. Petersen, director of the Alzheimer's

Disease Research Center at the Mayo Clinic in Rochester, Minn. This is a more significant memory loss than forgetting a name or where you left the car keys. Within six years of a diagnosis for MCI, some 80% of such patients progress to Alzheimer's.

Consequently, the Food & Drug Administration has signaled its willingness to overhaul its own criteria for judging brain-enhancing drugs. On Mar. 13, an FDA advisory group ruled that experimental Alzheimer's treatments can win approval if they improve memory function in people with MCI, even if they don't alter the course of Alzheimer's itself. This could mean a potential windfall for drug companies. There are currently 4 million Americans suffering from MCI and another 4 million with Alzheimer's disease, says Vincent Simon, CEO of Cortex Pharmaceuticals

Inc., a neuroscience company in Irvine, Calif. Those numbers will go up as the baby boomers age. In 2000, 35 million Americans were over 65, and by 2020 there will be 63 million. Alzheimer's strikes about 10% of people over 65.

The National Institutes of Health is leading the way in MCI research. In 1999, its National Institute on Aging announced it would sponsor a three-year multicenter study of over 700 MCI sufferers ranging in age from 55 to 90. This trial is designed to see if Pfizer Inc.'s leading Alzheimer's drug, Aricept, or vitamin E, can delay the onset of Alzheimer's or other forms of dementia. Other NIH-sponsored trials are testing estrogen and the popular anti-inflammatory drugs that are known as cox-2 inhibitors for the same purpose. "Such treatments can delay the onset of Alzheimer's disease for just one year," it could help between 220,000 to 440,000 people and save between \$1 billion and \$20 billion annually," says Dr. Leon Thal, head of the Alzheimer's Disease Research Center at the University of California at San Diego.

It will be at least three years before the NIH trials produce concrete results and some scientists are already questioning the value of the Aricept trial. "Pfizer is dying to use Aricept on MCI," says Harry M. Tracy, publisher of the newsletter *NeuroInvestment*. "But there is a big question about whether it works." The drug is one of three Alzheimer's treatments on the market. All of them block the breakdown of

Researchers are developing two groups of drugs: Enhancers to boost cognitive function and inhibitors to prevent plaque formation



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Spring 2000 – a 14-mile pipeline and six months stood between
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brain chemical called acetylcholine that is important in memory and other intellectual functions. But there is no proof the loss of acetylcholine plays as large a role in MCI as it does in Alzheimer's. And these drugs aren't even that effective against Alzheimer's—they help less than half of all Alzheimer's patients, and then for a period of only a few months or at most two years.

The problem, it seems, is that by the time a patient develops Alzheimer's, the damage is done. The disease is caused by a steady accumulation in the brain, over many years, of an insoluble protein called beta-amyloid. As it accumulates, it forms brain clogging plaque. Victims eventually lose all mental and physical functions, until they die, after about 10 to 12 years.

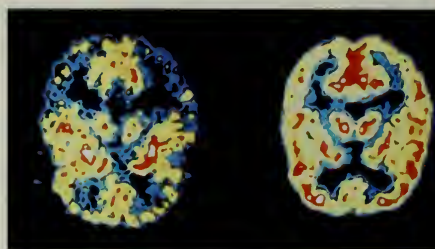
New drugs in the pipeline aim either to boost the brain's ability to form memories despite the plaque; or to slow the plaque buildup. In the first category are a group of drugs called ampakines, developed by Cortex in partnership with the French company Servier, that increase the activity of brain chemicals important to memory formation. Cortex is testing one of its ampakines in a small study of Alzheimer's patients. The company is planning a larger MCI trial with Servier for later this year.

Improved memory function is also the goal of NeoTherapeutics Inc. in Irvine, Calif. Its lead experimental drug,

Neotrophin, stimulates the production and release of growth factors in the brain's memory centers. These growth factors then coax neurons into making new connections with other nerve cells. Neotrophin has been tested in more than 1,000 Alzheimer's patients, with mixed results. Still, NeoTherapeutics President Rajesh C. Shrotriya says: "We believe that Neotrophin could have an effect in normal memory loss." Once the drug is approved for Alzheimer's, he plans to begin testing it in patients with MCI.

END RUN. The formation of memories, though, is a murky process. As researchers in this field feel their way along, they are testing a number of therapeutic approaches intended to aid the development of memories. Memory Pharmaceuticals Corp., a New York neuroscience company, is developing drugs that will help the brain convert transient short-term memories into stable long-term ones. This process, called long-term potentiation, is compromised in the aging brain and in Alzheimer's victims. Axel Unterbeck, president of Memory Pharmaceuticals, says the company has identified several promising drugs and hopes to start trials with Alzheimer's patients in two years.

Memory Pharmaceuticals is also trying to do an end run around the disease, with experimental drugs that enhance



FADING OUT

Brain function and blood flow are reduced in the brain of an Alzheimer's patient (right), vs. a normal patient

the activity, and perhaps the growth of undamaged neurons in the brain's memory centers. This approach could have wide utility in treating memory problems associated with dozens of diseases, including the normal forgetfulness linked to aging. "It's a very important notion that even if companies succeed in prohibiting amyloid production, the patient will still need treatment of memory problems," says Unterbeck. "We see using one drug that affects disease progression and another that improves function and keeps the patient at home."

Then there are the plaque-attackers. Several groups are working on vaccines that would stimulate the immune system to slough off the plaque deposits that lead to Alzheimer's. The leading candidate is from Elan Corp. in South San Francisco. In one test, Elan's vaccine caused a 70% reduction in amyloid plaques in the brains of mice genetically engineered to develop Alzheimer's. Elan, in partnership with America's Home Products, is now running early stage safety trials of its vaccine in people with advanced Alzheimer's disease. "If the immunization works in Alzheimer's patients, we will move to MCI very rapidly," says Dale B. Schenk, vice-president for research at Elan.

Beyond vaccines are efforts by Bristol Myers Squibb, Eli Lilly, and Elan to develop compounds that block the enzymes that help cause plaque. Other drugs under development are likewise meant to interfere with the process of plaque formation.

In three to five years, there may be more options for treating MCI and new methods for slowing the onset of Alzheimer's. Researchers are also trying to devise ways of detecting who is at risk for Alzheimer's years before it becomes apparent. In the end, the best chance of "curing" Alzheimer's may be targeting simple forgetfulness.

By Naomi Freundlich in New York

Gaining On Memory Loss

New drugs in the pipeline show promise in treating mild cognitive impairment (MCI), a form of forgetfulness that can be an early sign of Alzheimer's disease (AD)

DRUG CLASS	COMPANY	ACTION	STATUS
COX-2 INHIBITORS	Merck, Monsanto	Anti-inflammatory drugs that may reduce or delay AD	Clinical trials for AD and MCI
CHOLINESTERASE INHIBITORS	Pfizer, Novartis, and Janssen Pharmaceuticals	Increase the levels of a brain chemical involved in memory	Approved for AD, testing for MCI
SECRETASE INHIBITORS	Bristol Myers Squibb, Eli Lilly, Elan, Axonics	Prevent the accumulation in the brain of plaque, the possible cause of AD	Trials for AD, pre-clinical tests for MCI
ALZHEIMER'S VACCINE	Elan/American Home Products	Provokes the body's immune system into removing plaque	Trials for advanced AD
COGNITION-ENHANCING DRUGS	Cortex, Eli Lilly, NeoTherapeutics, Stem Cell Sciences, Memory Pharmaceuticals	Enhance the memory regions of the brain by boosting protective brain chemicals or promoting new connections between neurons	Range from advanced trials for AD to pre-clinical for MCI

Data: Company reports

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May 24	Albany, NY	(518) 435-4500
May 29	Frankfurt, Germany	(011-49) 69 68 60 7015
May 31	Rochester, NY	(716) 624-8245
June 14	Buffalo, NY	(716) 816-RACE
June 20	New York City #2	(212) 423-2248
June 21	Boston, MA	(617) 439-7700
July 11 & 12	London, England	(011-44) 207-620-4117
July 17	Stamford, CT	(914) 682-0637
July 19	Morristown, NJ	(973) 898-9386
July 25	New York City #3	(212) 423-2248
July 31	Long Island, NY	(516) 349-7649
August 7	Syracuse, NY	(315) 446-6285
August 9	Chicago, IL	(773) 777-9000
August 14	Paramus, NJ	(973) 898-9386
September 25	Atlanta, GA	(404) 255-1033, x10
October 6	Championship NYC	(212) 423-2248
November 14	Sydney, Australia*	(011) 61-2 94 39 6060

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EDITED BY ADAM ASTON



WELDING WITH LASER-BEAM PRECISION

LEUS HURLED BOLTS OF lightning at his enemies. And Flash Gordon zapped his foes with a laser. Back in the real world, a recently patented welding technology aims to merge these forces for more constructive uses. Developed by an Ohio State University team led by Charles Albright, professor of industrial engineering, the Laser Assisted Arc Welder (LAAW) promises to marry the low cost of arc welding with the precision of laser joining.

Traditional arc welding has the advantage of being inexpensive, but it's tricky to control. As powerful electric arcs snap from welding rod to the metal, they sometimes follow unpredictable, lightning-like paths, leading to sloppy welds and splattered metal. Laser welding, on the other hand, is

superprecise, but it requires a \$200,000 device, along with a multikilowatt supply of electricity. So far, only deep-pocketed car and aerospace companies can afford such systems.

Albright's solution uses a low-power laser to guide the path of the electric arc. It's not a brand-new idea, but in the past such a technique has worked only with expensive, high-powered lasers. The LAAW is able to make do with a 7-watt laser source—about as powerful as a Christmas tree bulb—thanks to a secret ingredient: a wisp of carbon monoxide gas in the welding chamber. Tuned to just the right frequency, the laser can strip electrons from the carbon monoxide as it passes through—making an attractive path for the welding arc to follow. Albright and his team found that when the arc was brought near the laser, it followed along as if through a pipe, landing precisely where the laser was pointed.

With the LAAW freshly patented, Albright and his colleagues are looking for support to go commercial. Because LAAW uses such a miserly laser, it will be cheaper to buy and to operate than a conventional laser welding system. One day soon, Albright hopes, a \$20,000 LAAW system, tethered to a \$5,000 power supply, will be able to do the work of laser joiners that now cost 10 times more. □

INNOVATIONS

That grit in your eyes last month may have come from China. NASA scientists using satellite instruments monitored what they are calling the largest dust storm in the northern hemisphere since 179. The cloud kicked up in northern China in April, then drifted over North Korea and Japan, ultimately raining dust over large swaths of North America before dissipating in the mid-Atlantic. See

<http://science.nasa.gov/headline/> for maps and images.

■ EPRISolutions, a subsidiary of the Electric Power Research Institute, will soon be installing fuel cells in a handful of Chicago residences to test the technology's economic and environmental benefits. The furnace-size cells, which convert natural gas directly to electricity, produce 3 to 7 kilowatts of electricity and could be commercially viable in about two years, according to EPRI.

TROUBLED KIDS: IT'S NURTURE, NOT NATURE

RESEARCHERS, WHO HAVE followed 593 families since 1975, report that the risk of certain mental illnesses triples in children whose parents are excessively harsh or abusive, or provide inadequate supervision.

In families with such poor parenting, 63% of the children developed depression, anxiety, drug abuse, or other psychiatric ailments by the time they were adults, says a report in the current *Archives of General Psychiatry*. The prevalence of such disorders in children in the general population is about 20%, said the study's lead author, Jeffrey G. Johnson, a

psychologist at Columbia University and the New York State Psychiatric Institute. The families were drawn from all socioeconomic levels.

It has long been known that troubled parents are at increased risk of having troubled children. But researchers did not know exactly what role parenting played. The study found that the tripling of the risk occurred with poor parents with mental disorders and with poor parents without mental disorders. "That's the astonishing finding," says Johnson. "It didn't matter if the parents had disorders or not. It was the way they raised their children that determined whether the child had a disorder." The study was funded by the National Institute of Mental Health. *Paul Raeburn*

MEASURING THE MUSCLE OF R&D SPENDING

THE \$419 BILLION CHEMICALS INDUSTRY IN THE U.S. IS A research-driven affair. And yet its share of total U.S. research and development has been declining for years, from 11% in 1956 to about 8% in the past decade. Nobody knows why chemical spending is receding in the total R&D pie. But one reason may be that nobody has ever quantified exactly what kind of bang chemical companies get for their research buck.

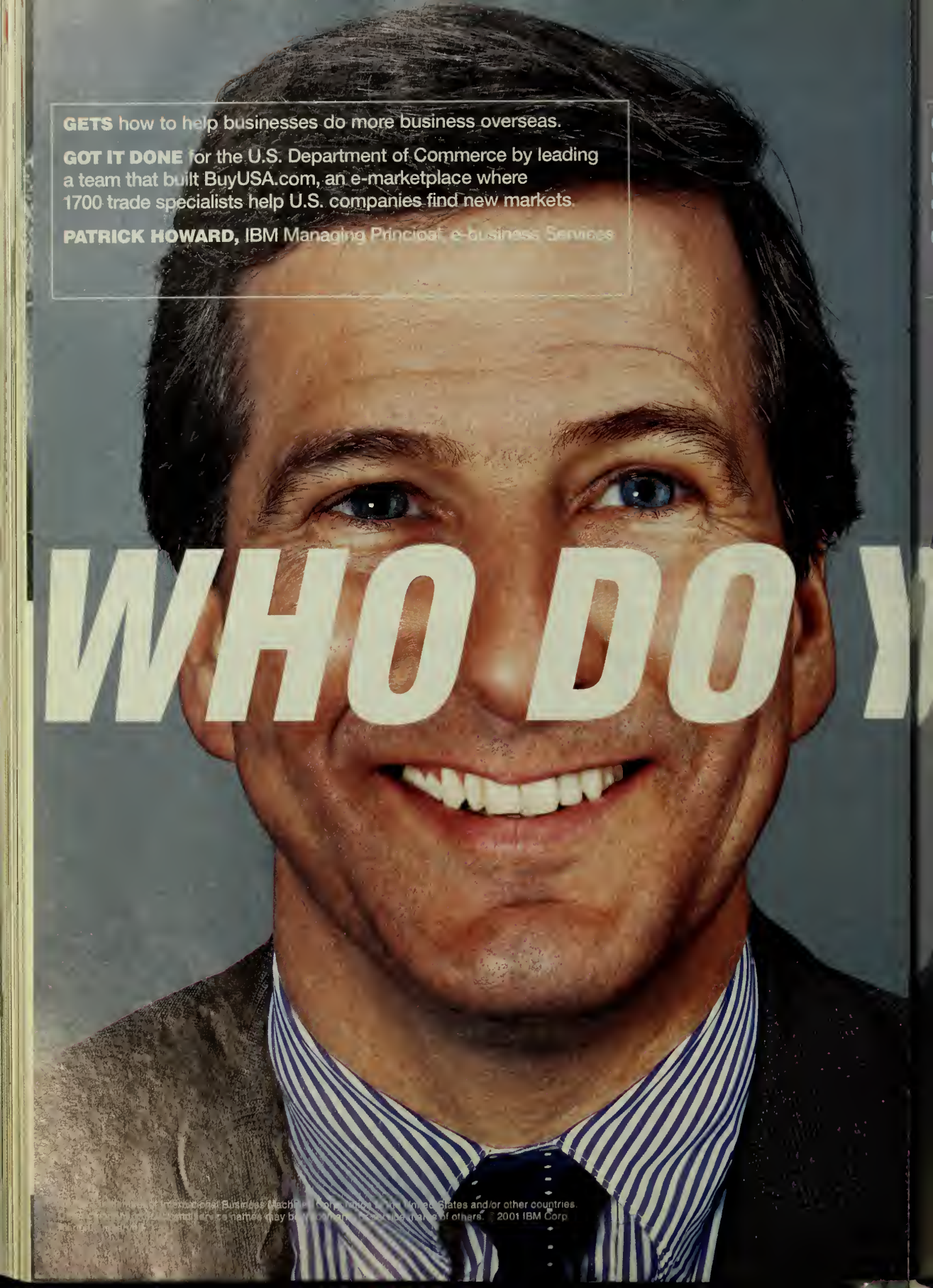


RESEARCHER: Earning her keep

Until now, that is. A new report from the Council for Chemical Research (CCR) analyzes data from more than 80 publicly traded chemical companies and concludes that on average, every dollar invested in chemical R&D today yields \$2 in operating income over six years.

Members of the CCR suspected there was a substantial payback. "But until now, everything had been quite anecdotal," says Richard M. Gross, vice-president for research at Dow Chemical Co. and vice-chairman of the CCR. "We wanted to fill that void." In the next phase of the study, CCR plans to look at results from specific types of R&D and mine them for leads on which topics should be pursued most vigorously.

Neil Gross

A close-up portrait of a man with dark hair and blue eyes, smiling. He is wearing a blue and white striped shirt and a dark tie. The background is a solid grey color.

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EXECUTIVE EDUCATION

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For one day, a cadre of neophyte chief execs will learn at the knees of seasoned pros

Harry C. Wendt, prepare to be scared straight. On June 21, the Consec Inc. chief and 19 other recently crowned CEOs will submit themselves to a one-day immersion course administered by a parade of corporate critics and longtime chief executives. Those instructors are convinced they might be the only thing standing between the newbie leaders and career disaster. Open only to CEOs who have held the post for less than three years, the course will be taught by professors from elite business schools, top professionals, and such executive suite veterans as Merck's Raymond V. Gilmartin, Consec International's Dennis Kozlowski, and Larry Bossidy, former head of MedSignal. "It's a boot camp for recently appointed CEOs," quips Rajiv L.

Gupta, CEO of Rohm & Haas since 1999, who leapt at the chance to enlist.

To be sure, the CEO Academy is more than just a novel experiment in executive education—it may be the poshest, most expensive boot camp ever. The brainchild of an innovative CEO roundtable, the academy was conceived as a way for recently anointed CEOs to learn the perils of life in the corner office and for old-timers to discuss the trials and tribulations of CEO life before a receptive audience. It will be held in the august Harold Pratt mansion on New York City's Upper East Side. Tuition for the one-day course is a cool \$10,000. But the lessons—dealing with the land mines that can bring an early end to a CEO's career—will be just as biting as the bark of any drill sergeant.

Newly minted CEOs expecting a lovefest are in for a rude awakening. The session on shareholder relations will be led in part by Nell Minow, a corporate governance agitator who has helped build bonfires under boards reluctant to deal with poor-performing CEOs. "My

THE FACULTY

Kozlowski will talk about the art of the deal; Gilmartin about coming in cold as an outsider



KOZLOWSKI



GILMARTIN

goal is to teach them what they need to do to avoid hearing from people like me in real life," says Minow, who will urge the CEOs to adopt performance-based pay plans, preferred by shareholders. Says Minow: "If they are responsive [to shareholders] in good times, they will have a better chance of keeping them on their side in a downturn."

BOARD APPROVAL If Minow's lecture reminds the new CEOs of one set of bosses, the presentation by superlawyer Ira M. Millstein, the dean of corporate governance, will urge them to pay heed to another: their board members. Millstein believes most new CEOs "would be just as happy not to have a board at all," and give it a low priority. To snap them out of that delusion, he'll warn: "There is nothing more important than getting to know the people who can fire you."

But the highlight of the CEO Academy will no doubt occur when veteran CEOs are asked to share their experiences. G. Richard Thoman, who was fired as Xerox Corp. CEO last May, will talk about the lessons he learned at both Xerox and IBM. Gilmartin, an outsider who reinvigorated Merck & Co., will discuss the special challenges facing CEOs who are brought in from the outside. And in an era when more than half of all mergers founder—often bringing down the CEOs who attempted them—Tyco's Kozlowski will discuss "the dark side of acquisitions." His advice to the rookie CEOs: Once a deal closes, "you have a very short window to create change, so speed is of the essence."

Most of the "students" can't wait to get started. "We're most able to learn when we're new in a job," says Amgen Inc. CEO Kevin W. Sharer, who got the top job a year ago and expects to benefit from people like Bossidy who have years of experience heading complex organizations. For Consec's Wendt, who also has been at the helm for a year, the academy is "a chance to think outside of the box that you find yourself in as a leader of a business." Even Gilmartin, who long ago joined the ranks of proven CEOs, says he's looking forward to "the



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Photographs by Miroslav Krajcovic

*In nature
we see reflections of our children.*

The tree is the strong one.

The ocean, rambunctious and untamed.

The sky, the absolute dreamer.

*And to choose the tree over the ocean
would be like choosing one child over the next.*

An impossibility as large as the world itself.

*The world's leading environmental groups are working together.
To find out how you and your employer can help,
please visit our Web site at www.earthshare.org.*



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Management

opportunity to listen to others talk about their experiences."

And that, say the group's founders, is the whole point. The CEO Academy is the creation of the M&A Group Inc., a CEO club formed in 1999 as a forum to discuss and facilitate mergers and acquisitions among members. The group has since evolved into something more: an arena that gives the reigning king of Corporate America "an opportunity to talk about the things that keep them awake at night," says co-founder Dennis C. Carey, a partner at

THE STUDENTS

The CEO Academy provides a chance for new corporate chiefs to "think outside of the box that you find yourself in as a leader of business," says Conesco's Wendt



SHARER



WENDT



GUPTA

headhunter SpencerStuart Inc. The group has grown to 60 members, including such influential CEOs as Dell Computer's Michael S. Dell and AT&T's C. Michael Armstrong. They quickly realized new CEOs needed help getting their bearings.

The reason? While these industry titans get paid a king's ransom whether they succeed or fail, job security is a thing of the past. "This is a high-risk job," says Kozlowski, the M&A Group chairman. "Our ranks [turn over] about 20% every year." And with the honeymoon period growing ever shorter, new CEOs have little time to get up to speed. Moreover, "many new CEOs have limited experience in running a board, in dealing with Wall Street, the business press, and shareholders," says Carey. That's why he recruited CEOs as instructors. "I wish I'd had [the chance to attend] a forum like this when I came CEO," says Kozlowski.

Of course, the ultimate test of a boot camp is whether it reduces the casualty rate among participants. It takes years to measure the effectiveness of the academy, which the M&A Group hopes to host annually. But with more CEOs crashing and burning, it sounds like a step in the right direction.

By William C. Symonds in Boston

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AOL Keyword: BusinessWeek



HOT GROWTH COMPANIES

INNOVATIVE SMALL-CAP COMPANIES ARE TURNING CREATIVITY INTO PROFITS—AND BEATING THE PANTS OFF OF CORPORATE AMERICA

William J. Prange, chief executive of women's clothier Christopher & Banks Corp., is on a financial tear. For the past three years, Prange has led the once-floundering retailer on a desperately needed sales and earnings hot streak. When he came aboard in 1994 as a general merchandising manager, the company, then called Braun's Fashions Corp., was a failing chain of department stores selling low-priced women's wear. It had terrible

sales, unmotivated employees, and no clear idea who its target customers were. "We were trying to be everything to everybody, and consequently we meant nothing to anybody," Prange says.

Promoted to CEO in 1998, Prange set to work overhauling the company. He beefed up customer service, redesigned the stores, and focused on clothing that appealed to baby boomer women. Along the way, he renamed the company Christopher & Banks, after one of Braun's private clothing lines. Says Prange: "It sounded classier, and we wanted to get away from Braun's image as a budget clothing store." Those changes almost immediately jump-start-

ed growth at the clothier. In the years 1998 through 2000, Christopher & Banks had average annual sales growth of 28% and earnings growth of nearly 82%. Over the past four quarters alone, earnings rose 121%, to \$25.5 million, on sales of \$209.2 million. That performance was good enough to land the company the No. 16 spot on *BusinessWeek's* ranking of 100 Hot Growth companies. Last year, as Braun's, it ranked No. 70.

Another up-and-coming fashion outfit, Chico's FAS Inc., also jumped onto the Hot Growth list, at No. 6, by targeting baby boomer women with high incomes. Like these retailers, the companies on our Hot Growth list have found a way to rake in cash during both a fast econ-

omy and a slow one. They have managed to do it through innovation, a willingness to refocus when times get tough, and by delivering the right product aimed at the right customer. A vibrant market of smart, creative small companies bodes well for a Corporate America struggling through a nagging downturn. "One of the ways we get out of slumps is through innovations, and historically, those innovations come from small-cap companies," says Wells Fargo & Co. Chief Economist Sung Won Sohn.

ON THE RISE. More important, the companies on our list are turning creativity into profits. Overall, the 100 Hot Growth companies have pumped out average annual sales and earnings growth of 42.4% and 80.7%, respectively, over the past three years. Compare that with 11.5% sales growth and 15.6% earnings growth for the companies in the Standard & Poor's Industrials index. And what about their returns on capital? *BusinessWeek's* 100 Hot Growth companies averaged 20.3%, while the S&P Industrials eked out just 9.3%.

While many of the largest U.S. corporations have seen their growth—and stock prices—stall, plenty of smaller outfits have held their own. The Russell



Retailers are finding that, along with teenagers “women over 40 are a large and profitable” niche

2000, a small-company stock index, rose 0.81% in the year ended Apr. 30, while the Standard & Poor's 500-stock index slid by 5%. “If you look at the small-cap indexes in general, they have been outperforming the large caps,” says Thomas L. Press, portfolio manager for Strong U.S. Emerging Growth Fund.

How did the companies on our list make the cut? *BusinessWeek* ranks publicly held companies based on average sales and earnings growth and average return on capital over three years. That gives us time to get a fair reading of a company's track record. This year, we looked at candidates with sales of \$50 million to \$1.5 billion. That's a wider net than last year, when the floor was \$25 million and the ceiling \$500 million.

After all the numbers were crunched, the ranking revealed a small-cap sector that's still a hotbed of innovation and growth. Our Hot Growth list includes companies from all corners of the economy, from candymakers to chipmakers. The technology sector overall may be hurting, but there are plenty of high-tech winners on hand. The No. 1 company on the list is Optical Communication Products Inc., which racked up a stellar 48% average return on capital over the past three years by selling optical-electronic devices used in building high-speed data networks. The transportation industry is represented by Frontier Airlines Inc. (No. 14), a low-cost carrier out of Denver that cashed in by focusing on vacationers and budget-minded business flyers. Direct Focus Inc. (No. 2) generates top returns by direct-marketing of exercise equipment.

While the Hot Growth list includes a broad array of industries, among the strongest were those catering to consumers. Nine of this year's top 20 companies are consumer-oriented. That's up from five last year, when technology companies ruled the roost. The list is filled with apparel stores, footwear companies, sporting-goods retailers, and a bevy of amusement and recreational-service providers. “The interesting thing about the economic slowdown is that consumer spending has not slowed all that dramatically,” says Steven G. De-

Sanctis, director of small-cap research at Prudential Securities Inc.

Indeed, apparel retailers made a strong showing primarily by tapping into two lucrative consumer pockets—working women and teenagers. Christopher & Banks' Prange says “women over 40 are a large and profitable piece of the population.” And while teenagers may have less money, many of them spend what they have with abandon. Both Abercrombie & Fitch Co. (No. 15) and American Eagle Outfitters Inc. (No. 13) have successfully tapped into the teen-clothing market. “They know what teens want, and teens want what they see on *Dawson's Creek* and music videos,” says Morningstar stock analyst Mike Porter.

Many of the info-tech companies in *BusinessWeek*'s ranking dodged the tech-spending slowdown by targeting still-thriving specialized niches. Micrel

Inc. (No. 18) hit a gusher in these energy-conscious times with power-management chips for computers, cell phones and personal digital assistants. Cal Microelectronics Corp. (No. 11) pulled great returns—average annual three-year sales and earnings growth of 72% and 244%, respectively—by providing polishing technology for a new copper-based chipmaking process. “We have leadership technology position, and that gives us a huge advantage,” says CEO Matthew Neville. But that doesn't mean these companies are immune to the slowdown. Cabot shares took a recent hit when the company reported that the softening market for computer chips had clipped sales by 19% in the second quarter compared with the first.

Some software companies have managed to outrun the tech slump by specializing. Mercury Interactive Co. (No. 43), for instance, cranks out software that lets companies test and monitor their Internet applications. Its annual earnings increased an average 106% in the past three years. The good news for these companies is that experts say software is likely to be one of the first purchases companies make when tech spending picks up again.

“MEAT AND POTATOES.” Keeping a tight focus has also helped the management consultants on our Hot Growth list. They have been able to ride through the tough times—so far—by providing nuts-and-bolts services to specific markets. Professional Detailing Inc. (No. 10) concentrates on sales and marketing services for the pharmaceutical industry, including helping biotechnology companies launch new brands. Its annual earnings growth averaged 69% over the past three years. Maximus Inc. (No. 45) counsels U.S. government agencies on how to improve their efficiency. “These companies do meat-and-potatoes type stuff,” says Tom Rodenhauser, president of searcher Consulting Information Services LLC. “The need for that is always going to be there.”

Some of the Hot Growth names should come with a flashing yellow light. Several have warned that their breakeven earnings growth will slow along with the economy. And because they're moving so fast, many of these businesses involve risks that can knock them for a loop at any second. Hot fads, for instance, can turn cold. That may si-

THE WINNERS BY THREE MEASURES

SALES GROWTH*

IXIA	293.3%
NVIDIA	187.3
TAKE-TWO INTERACTIVE	158.8
OPTICAL COMMUNICATION	127.9
DIRECT FOCUS	122.8

*AVERAGE ANNUAL SALES GROWTH FOR PAST THREE YEARS

EARNINGS GROWTH*

MAPINFO	849.0%
IXIA	399.5
NVIDIA	391.9
CORINTHIAN COLLEGES	255.4
CABOT MICROELECTRONICS	244.0

*AVERAGE ANNUAL EARNINGS GROWTH FOR PAST THREE YRS.

RETURN ON CAPITAL*

CORPORATE EXEC. BOARD	61.4%
DIRECT FOCUS	51.1
OPTICAL COMMUNICATION	47.8
FRONTIER AIRLINES	47.0
ABERCROMBIE & FITCH	46.8

*AVERAGE FOR PAST THREE YEARS

Data: Compustat, provided by Standard & Poor's Institutional Market Services



MPG 52/45

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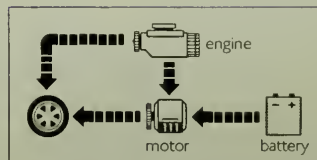
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trouble for Topps Co. (No.12), known for its trading cards. The Pokémon card craze has faded, and without new winners, Topps could see slower growth.

Others face more serious issues. Steven Madden, founder of shoe company Steven Madden Ltd. (No.27), pleaded guilty in May to charges of securities fraud and money-laundering. The company announced that he will

step down as CEO on July 1 but remain chief creative designer. That could be a challenge, since Madden faces a possible prison sentence of 41 to 51 months. He will be sentenced in September.

It has not been an easy year for even the hottest-performing small companies. But life could get easier if it turns out the economy is really bottoming out. But even if the worst is yet to come,

our Hot Growth list shows that there are always companies that will find ways to prosper no matter how tough the going gets.

By Darnell Little in Chicago

BusinessWeek online

For more on Hot Growth companies, go to the June 11 issue at www.businessweek.com

ONLY SOME OF THE HOT STAY HOT

Investors in search of a roller-coaster ride couldn't ask for a more volatile group than *BusinessWeek's* Hot Growth companies. Consider these two companies from the 1999 list. At Applied Micro Circuits Co., a San Diego company in the white-hot optical networking business, revenues grew by 64% in 2000 and 153% in 2001, and its stock price has nearly quadrupled in two years. By contrast, Vitech America Inc., a Miami PC maker with markets in Brazil, has seen its shares plummet 90%. The Brazilian currency tanked, fire destroyed a key plant, and the company is in a legal battle with PC giant Gateway Inc. Says President William St. Laurent: "This is not [a stock] for widows and orphans."

To see if the 100 Hot Growth companies have maintained their performance or were just corporate flashes-in-the-pan, *BusinessWeek* waits two years to revisit them—enough time to take into account any short-term anomalies. The last two years, marked by a dot-com implosion and a slowing economy, were tough ones for the class of '99. It had a two-year market-weighted return of 52.3%, a far cry from the 149% two-year gain of the class of '98. Even so, that far outpaced the Russell 2000's 15.3% gain for the same period and the Standard & Poor's 500-stock index' 4.2% loss.

But that overall performance masks extreme volatility. Seven com-

panies that ranked near the bottom of the 1999 list were among those with the best two-year stock performance, while five ranked near the top were among the biggest laggards. The biggest loser: Friede Goldman Halter Inc., a Gulfport (Miss.) builder of oil rigs that ranked No.1 in 1999 and filed for Chapter

accelerate his company's growth by building faster chips and expanding its technology offerings. No. 97 Barr Laboratories Inc., a generic drug-maker in Pomona, N.Y., has seen its stock price soar 189% over two years, says CEO Bruce L. Downey, thanks to aggressive patent challenges and savvy marketing. When patients feared switching from DuPont Pharmaceutical's popular blood thinner, Coumadin, to Barr's generic version, Barr conducted studies that showed no adverse effects from the switch. Since 1999, Barr's market share has nearly doubled. Says Downey: "That has remained a very profitable product."

"FRESH GO." When companies can't respond quickly to external forces, however, they can suffer. Cotelligent Inc., a San Francisco consultant, says the slowdown in tech spending has cut revenues and profits by 75% since the fiscal year ended March, 1999. After shifting the company's focus from enterprise software to wireless, CEO James R. Lavelle is hopeful: "We've got the opportunity to make a fresh go of it."

Being smart enough to overcome

problems is what marks a strong Hot Growth company. Several of those profiled this year, such as Frontier Airlines Inc. and Chico's F.A. Inc., went through tough times but pulled through. The best companies, of course, almost always do.

By Louis Lavelle in New York



THE 1999 WINNERS...

TWO-YEAR TOTAL RETURN*

APPLIED MICRO CIRCUITS	290.5%
VERITAS SOFTWARE	277.8
VIASAT	269.1
JACK HENRY & ASSOCS.	246.0
RESMED	238.9
BARR LABORATORIES	189.2
QLOGIC	145.3
TECHNE	134.0
ANCHOR GAMING	130.7
SBS TECHNOLOGIES	120.7

*Calculated using the stock price as of Apr. 30; excludes companies not trading on that date
Data: Compustat, provided by Standard & Poor's Institutional Market Services

...AND THE LOSERS

TWO-YEAR TOTAL RETURN*

FRIEDE GOLDMAN HALTER	-98.7%
COTELLIGENT	-95.7
VITECH AMERICA	-90.3
TARRANT APPAREL GROUP	-89.5
COAST DENTAL SERVICES	-89.3
IGATE CAPITAL	-84.5
GLOBAL PAYMENT TECH.	-82.9
MEDIALINK WORLDWIDE	-82.5
RWD TECHNOLOGIES	-79.7
METRO INFORMATION SVCS.	-78.7

11 bankruptcies two years later.

The Hot Growth companies from 1999 that have thrived are mostly technology companies with smart management and good products. Until the tech slowdown, David Rickey, CEO of Applied Micro Circuits, ranked No.66 in 1999, managed to

Chico's FAS



RANKING No. 6

LOCATION Ft. Myers, Fla.

SALES \$259.4 million

EARNINGS \$28.4 million

WHAT'S HOT The company almost went broke, but it's back, offering stylish and comfortable clothes for a growing demographic: Women over 35.

● **FAMILY AFFAIR:** THE GRALNICKS, CEO AND DESIGN V-P, ADD 50 STORES A YEAR

HOW CHICO'S GOT ITS GROOVE BACK

The fashion retailer focused on a customer, a look, and an ambience—and added a few sales tricks

When Marvin J. Gralnick retired in November, 1993, as CEO of Chico's FAS Inc.—the women's apparel chain he started with wife Helene a decade earlier—the company had just gone public, business was strong, and the Gralnicks looked forward to years of leisure. It would be a short retirement. After they left, Chico's, which had been selling casual cotton resort clothes, changed radically and instead began

selling large-size clothes for women. A year later, the Gralnicks raced back to the rescue. As Marvin, 66, bluntly puts it: "The company was going out of business." It took him and Helene, now 53 and senior vice-president of concept and design, three years to set things straight. In that time, they rejiggered the merchandise mix to come up with what has proven to be a winning formula: lines of loose-fitting stylish separates that flatter their over-35 women customers.

The turnaround landed Chico's at No. 6 on the Hot Growth list. From 1993 through 2000, its sales increased by an average 50% per year, with earnings climbing an annual average 112%. When the Gralnicks left in 1993, their 32%

stake in Chico's was worth \$21 million; now their 13% share is worth \$100 million. And with a new management team, Marvin predicts a thriving business for years to come. "We can visualize this as a \$1 billion-plus company with 500 to 600 locations," he boasts.

Chico's has 260 boutique-style stores, usually located in high-end malls, and it is adding about 50 stores per year. Each one purveys stylish original fashions of the sort its customers—mature women with household incomes of \$75,000 or more—often have trouble finding. Talbots Inc. comes closest, but its clothes are generally more conservative than those at Chico's, where an oversize linen shirt, for example, goes for about \$60. And the small Chico's stores specialize in pampering customers. "They've made women in their 40s and 50s feel that this is really a place for them to get terrific fashion value," says New York retail consultant Wendy Liebmann.

"MIND-BOGGLING." The company—named for a friend's bilingual parrot—is one of the hottest plays in retail. Same-store sales grew 23% in 1999 and 34% in 2000, boosted by the popular Travelers Collection of wrinkle-free, ribbed-knit separates and a 900,000-member loyalty program that gives customers 5% off after spending \$500. Sales are also driven by the catalog mailings to 1.2 million households. In fact, sales growth has bested even retailing superstars like Talbots. "These are mind-boggling numbers," says Southwest Securities retail analyst Ozarslan Tangun.

Chico's has some neat tricks to keep sales climbing. There are no mirrors in the dressing rooms, so when shoppers step back on the sales floor to find one, clerks use the chance to sell additional items. That's how Carolyn Collins, 57, a Christian-education coordinator in Atlanta, spent \$1,500 the first time she shopped at a Chico's three years ago. "The service is great, and I like the look—stylish but comfortable," says Collins, who makes twice-yearly pilgrimages to the store. "My problem is to quit buying when I'm here."

Gralnick was a college dropout designing leather jackets in Mexico in the early '70s when he met Helene, then vacationing in Guadalajara. There was "something at first sight," she recalls. They married in 1972 and by 1983 opened their first store in Sanibel Island, Fla. Today, Chico's operates in 40 states and has begun a national TV ad campaign to build brand recognition. But thankfully for Chico's, word is already out.

*By Aixa M. Pascual
in Fort Myers, Fla.*

THIS COMPANY LIKES IT IN JAIL

ASG sees its future in providing health care to a captive population—and that population is soaring

What do you get if you cross *ER* with *Law and Order*? Answer: America Service Group Inc. (ASG), whose hot specialty of providing contract health services for prisons and jails has won it the nickname "HMO behind bars" among Wall Street wags.

Governments are increasingly eager to off-load the costly task of providing health services to inmates. So who will care for this captive market? Enter ASG, whose corporate lineage dates to 1978 when Jacqueline Moore, a nurse fed up with the quality of prison care, founded Prison Health Services Inc. She has since left to become a consultant to governments on the issue. The company is run now by CEO Michael Catalano, a onetime attorney for Bechtel Corp. He joined ASG five years ago as general counsel, after stints at Charter Medical Corp. and at Columbia/HCA Healthcare Corp.'s prison health program. Under his guidance, ASG has been running strong. Revenues have jumped an average annual 51% over the past three years, while profits grew an average of 55%.

ON THE FENCE. Thanks to ASG's recent success landing some high-profile contracts—including a three-year \$300 million deal inked last December to care for 13,000 prisoners at New York's Rikers Island—many investors believe that ASG could grab an even bigger share of the \$4.5 billion that governments spend on prison health services. "If they execute the Rikers contract well, it could generate a tremendous amount of new business from governments who are still on the fence about outsourcing," predicts Andrew Taylor, a Nashville money manager who holds 145,000 shares of ASG.

While private prison management remains controversial, government officials are slowly acknowledging that health care is so specialized it may indeed best be left to outsiders. What's driving governments to outsource is not just the liability risks—prisoners and

their families are quick to sue for malpractice—but costs. Economies of scale allow ASG to wheedle greater discounts from suppliers. As a result, ASG promises savings of as much as 27% below what states and municipalities would spend on the same services. And ASG likes to brag that it is not just cheaper, but better. In Indiana, Robert Ohlmler, deputy commissioner of the Corrections Dept., says that ASG so improved care for its 21,400 inmates that the state recently received its first-ever accreditation from the National Commission on Correctional Health Care, while saving \$26 million in three years.

But in some states, ASG has faced

criticism that it stints on care to maximize its profits. In Maine, Cumberland County Sheriff Mark N. Dion cited a "tidal wave of inmate grievances" about inadequate medications and dental care at a Portland jail. Dion says ASG nurses were pulling 24-hour shifts. He pulled the plug on the ASG contract last September. In its defense, ASG says that the jail's prisoner count was sometimes 40% higher than it had been led to expect. Some inmate suits allege that substandard care led to deaths. Catalano says that patient deaths are not out of line with those at traditional hospitals.

With the prison population projected to grow at a 6% annual clip, Catalano is confident that ASG has room for growth. Still, he thinks ASG can parlay its skills into other fields, including military and veterans care, even temporary staffing at traditional hospitals. "There's a huge market for clinical staffing, and that's a core competency of ours," he says. ASG may make a jailbreak, but for now prison suits it just fine.

By Dean Foust in Brentwood, Tenn., with Brian Grow in Atlanta

America Service Group



RANKING No. 23

LOCATION Brentwood, Tenn.

SALES \$443.7 million

EARNINGS \$8.5 million

WHAT'S HOT ASG gets paid to provide health care to prison inmates. Now it wants to take its expertise to the military and regular hospitals, too.

● ASG CEO CATALANO WITH A CLIENT: THE DAVIDSON (TENN) COUNTY JAIL

WHEN COOL HEADS PREVAIL

Aaon, an air-conditioning and heating-systems maker, has a plum niche and a list of prestigious clients

When a corporate giant that accounts for 25% of sales leans on a tiny supplier for better prices, the only solution is for the supplier to knuckle under, right? Not if you're Norman H. Asbjornson, CEO of Aaon Inc. Indeed, in 1991, Asbjornson, a 65-year-old former tank mechanic for the U.S. Army who's tough as

nails, turned down a request from McDonald's Corp. to slash prices on Aaon's rooftop air-conditioning and heating systems. The upshot, he says: "They did just what they said they would do, and we lost all of the McDonald's business."

It took Asbjornson a year to replace that revenue, as he laboriously lined up independent manufacturers' reps to hawk his commercial-heating, ventilation, and air-conditioning equipment to new customers. But Asbjornson has no regrets about turning down Mickey D's. "I knew I was taking a chance, but what was the point [of cutting prices] if I couldn't make any money?"

Making money certainly hasn't been an issue recently. Over the past three

years, profits climbed an annual average 64%, while sales rose 23% on average. And the hot streak has continued. Aaon, No. 34 on the Hot Growth list, reported first-quarter earnings in 2001 were 17%, to \$3.6 million, while sales jumped 11%, to \$39.4 million. And Aaon is sitting on a \$33.4 million backlog of orders, including projects for Wal-Mart Stores, Target, and Home Depot.

ROOFTOP MARKET. Nabbing such prestigious clients is no small feat for Aaon, which is a fraction of the size of industry giants Trane, Carrier, Lennox, and York. But Aaon has grabbed a 12% share of the \$1.4 billion rooftop air-conditioning market by carving out a niche of semi-customized cooling systems, positioned between low-priced commodity equipment and high-end customized systems. Aaon, for instance, can tailor one of its regular production lines to make units with special heat-recovery options unavailable on low-end systems. By combining custom features with assembly-line production, it can offer customers big savings, says analyst Keith A. Newcomb of A.G. Edwards & Sons Inc. Aaon's prices are about 5% higher than low-end products but only one-third that of a customized system. "Aaon is an innovative company that has really turned the industry on its head," adds Jim Laird, director of engineering for Home Depot, which has given 70% of its business to Aaon.

That's what Asbjornson, previously vice-president at the air-conditioning division of John Zink Co. in Tulsa, had in mind when he began designing new cooling equipment in July, 1987. As he did so, he also put up his \$70,000 life savings and raised \$8 million from banks and private investors to buy the Zink unit where he worked. In November, 1988, the first equipment rolled off the line for the new company, Aaon. The made-name was near the top of the telephone-book listings. In 1989 he took it public at \$23 a share. The stock, of which he owned 20%, recently traded at \$23.

Wal-Mart, Target, and Home Depot accounted for 38% of the 18,000 units Aaon sold last year. But with a sluggish economy—65% of Aaon sales go into new construction—and emerging competition in the semi-custom market, Asbjornson is expanding his product line. He's also stretching his customer base to include schools and hospitals. "The past five years leave little doubt that we have gained a significant level of momentum," says Asbjornson. The challenge now is to maintain it.

*By Stephanie Andersen
Forest in the*

Aaon



RANKING No. 34

LOCATION Tulsa

REV. \$159 million

EMPLOYEES 13.3 million

WHAT'S HOT Creating a market niche of semi-customized air-conditioning systems for corporate customers has led to sizzling growth.

● **ASBJORNSON HAS "TURNED THE INDUSTRY ON ITS HEAD," SAYS A CUSTOMER**

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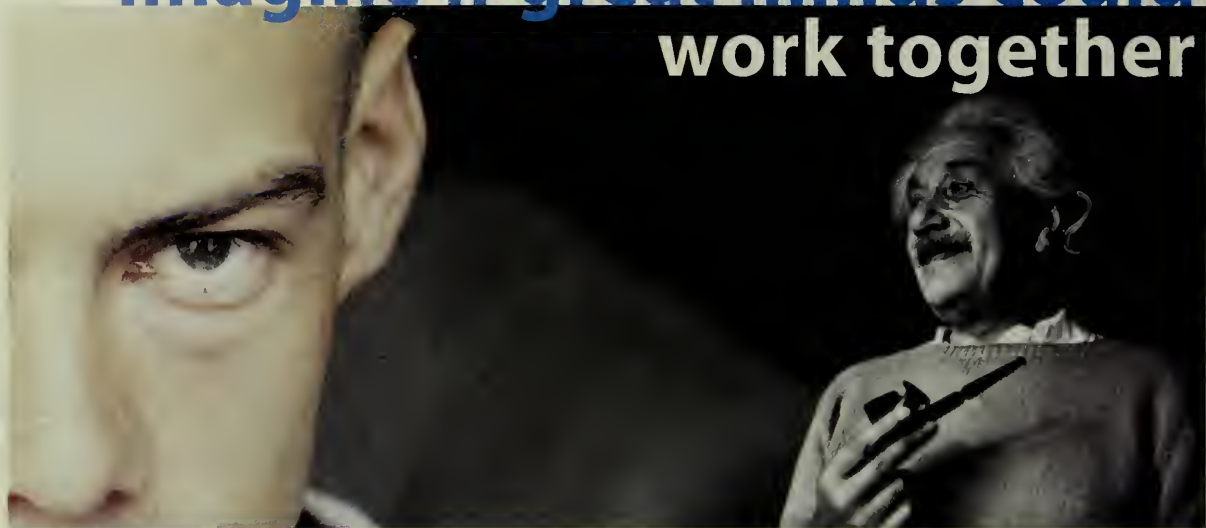
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CASHING IN ON THE GAMES PEOPLE PLAY

The graphics-chip superstar has muscled out most of its rivals with on-time delivery and top-notch engineering

Jen-Hsun Huang's experience as chief executive of graphics-chip superstar NVIDIA Corp. reads like a motto of the TV show *Survivor*: Outwit, last. Outplay. In an industry where the word cutthroat is an understatement, Huang's company has bested virtually all rivals in developing the innovative chips that bring high-tech, Hollywood-style 3D games to computers, game consoles, and set-top boxes. Says Huang, 37: "Our business is in fire because we've got a competitive spirit to create better products faster than anyone out there."

Indeed, since 1997 the company has churned out a string of best-selling graphics-processing chips. Although the semiconductor industry is notoriously cyclical, NVIDIA has benefited from steadily increasing demand by savvy gamers eager for its sophisticated graphics processors. In the way, a slew of less-successful graphics chipmakers has faded, leaving NVIDIA with two serious rivals, ATI Technologies Inc. and Intel Corp. Says market analyst Peter Labe at Buckingham Research: "Five years ago, we had about 8 to 10 competitors. But today there are only two because NVIDIA's pushed the small fry by delivering time products that offer top performance."

PONG PROWESS. The big reason for NVIDIA, No. 17 on the Growth ranking, is that Microsoft Corp. has asked it to develop the core of its new game console, the hotly awaited Xbox. NVIDIA's GeForce chip, which forms the console's

core, uses more than 30 million transistors—a design more complex than Intel's new Pentium 4 chip. Xbox' success could give NVIDIA a huge share of the \$11 billion computer-game business.

NVIDIA's road to stardom hasn't been all fun and games. In fact, Huang, a Stanford University-trained engineer born in Taiwan, isn't even a gamer. But as a child—he came to the U.S. when he was 10—he was, say those

who know him, a top-notch ping-pong player. He became interested in the business only when NVIDIA's other co-founders, Chris A. Malachowsky, now vice-president of hardware engineering, and Curtis R. Priem, chief technical officer, persuaded him to join in the new venture. Before that he worked at chip-maker LSI Logic Corp. Huang says that NVIDIA's feature-laden first chip flopped in 1995 because of poor performance.

The company regrouped with a new graphics processor two years later and hasn't looked back. Revenues were only \$29 million in 1997 but have grown at a 187% average annual clip over the past three years. For the most recent 12 months, revenues rose to \$735.3 million. By the end of this fiscal year, in January, 2002, they're projected to top \$1.1 billion, or \$924,000 per employee, more than double the industry average. Profits have grown by an average 392% over the past three years, to \$99.9 million.

TOP ENGINEERS. It will be hard for rivals to elbow NVIDIA out of its position. Analysts say newcomers can't afford the \$75 million needed to design similar chips. Even if they could, NVIDIA has hired most of the best engineers in the field. Intel and ATI are fighting back by cutting prices, but NVIDIA matched them by renegotiating a deal with one of its largest contract manufacturers.

NVIDIA has also set its sights on growth opportunities outside gaming. By next year, it is expected to grab more than 60% of the desktop computer market, according to Buckingham Research, up from 48% today. That will pit it even more directly against Intel, which dominates that low-end graphics-processor market. Huang says he will also seek to expand NVIDIA's reach into high-end notebooks and other computers, where Intel isn't nearly as strong.

Huang boldly predicts that NVIDIA will prevail. "The strong will get stronger," he says. Of course, NVIDIA could stumble as PC sales weaken. That might knock its thinly traded, high-priced stock—about \$80 a share—for a loop. But barring a total PC collapse, this is one company that seems to be at the top of its game.

By Cliff Edwards
in Santa Clara, Calif.

NVIDIA



RANKING No. 17

LOCATION Santa Clara, Calif.

SALES \$735.3 million

EARNINGS \$99.9 million

WHAT'S HOT If your PC games look great, NVIDIA's chips probably helped. Its images should turn up on Microsoft's Xbox console this fall.

● **WILL CEO HUANG—AND NVIDIA'S STOCK—KEEP UP THE FAST PACE AS PC SALES WEAKEN?**

A SIMPLE AND ELEGANT FLIGHT PATTERN

By ruthlessly keeping costs low, upstart Frontier is not only staying aloft but racking up profit growth

When Samuel D. Addoms launched Frontier Airlines Inc. in 1994, he knew that most startup carriers never make it. But Addoms believed he had a can't-miss plan that would allow his little venture to beat the odds: Frontier would become a low-cost regional feeder to one of the two big carriers that

vanished," recalls the chief executive.

You wouldn't guess that from Frontier's numbers today. The Denver-based carrier ranks No. 14 on this year's list of Hot Growth companies. Frontier's revenues have soared an annual average 46% over the past three years, while earnings have gone up nearly 33%. It has returned a stellar 47% on invested capital. Its shares, which went public at \$2.46 apiece in May, 1994, now fetch about \$16.

PLAN B. How did Addoms pull it off? On the fly, he drew up a Plan B. Rather than gathering up passengers from small towns in North Dakota only to pass them off to UAL's United Airlines in Denver, Frontier morphed into a more typical discount airline aimed

Frontier Airlines



RANKING No. 14

LOCATION Denver

SALES \$450.6 million

EARNINGS \$53.8 million

WHAT'S HOT A no-frills, low-cost airline that has stuck around. Frontier started out as a short-haul carrier but now flies coast to coast.

● **ADDOMS' AIRLINE NEEDS TO AVOID AN ALL-OUT PRICE WAR WITH UNITED**

dominated Denver. Within months, however, Continental Airlines Inc. abandoned its money-losing Denver hub. And without a rival, UAL Corp. saw no reason to link up with Frontier or anyone else. So much for Addoms' sure thing. "I thought we would join the list in the big book of airlines that have

at vacationers and the subset of business travelers who put cheap fares ahead of convenience and frequent-flyer points. Frontier kept some of its early routes, such as those to El Paso and Albuquerque. But its schedule soon began to look more like United's, with service added to Chicago and Los An-

geles in 1995, New York in 1997, Atlanta, San Diego, and Dallas in 1998.

Like most low-fare airlines, Frontier admittedly is handicapped in head-to-head competition with United. It offers just two or three daily flights to big markets. None of its two-dozen Boeing 737 jets has business-class seating. All passengers are served only cold sandwiches or bagels on its no-frills flights. But Frontier's last-minute ticket prices are generally 40% to 60% below United's, thanks to its mainly nonunion workforce and tough attitude toward costs—employees, for instance, need permission from Addoms himself to use the color printer at headquarters. The result? United's walk-up fare between Denver and New York is \$2,173 round trip. Frontier charges only \$844.

The airline also has a secret weapon: Addoms. Before signing on at Frontier, Addoms, now 61, spent 35 years leading young companies public or stepping in as a Mr. Fixit at established outfits in trouble. Frontier needed his turnaround touch. A previous Frontier Airlines went belly-up in 1986 after 39 years in business. Many flyers remembered that. But Addoms' skills helped build a new image. "We have a positive, energetic environment," says Jeff S. Potter, who resigned as Vanguard Airlines Inc. in May 1994 after 11 months to return to Frontier as chief operating officer. "All of it comes from Sam."

LOW PROFILE. Frontier just logged its 12th straight month of sales growth. It is still in the black, even as UAL and most other carriers are posting losses. But it isn't entirely in the clear. More than 70% of the traffic at Denver is United's. United has been able to ignore Frontier, which has only an 8% share. Some analysts warn, however, that United may feel threatened by further Frontier growth and strike back by slashing fares and adding flights. That, along with rising fuel costs, could cripple Frontier. "The whole strategy depends on staying under United's radar," cautions Michael Levine, a Harvard University professor and former airline executive.

For now, UAL has its hands full trying to win antitrust approval of its takeover of US Airways Group Inc. If it wins, analysts say that it will take UAL years to mesh the two airlines. By then, Frontier could be too big to go down with a fight. It's already switching to a fleet of new Airbus planes and instituting a frequent-flyer program. If air traffic in Denver continues to rise, Frontier can be growing at a fast clip without cutting into United's share. After a rough start, Frontier may be airborne for good.

By Michael Arndt in Chicago

Delta & Pine Land



RANKING No. 42

LOCATION Scott, Miss.

SALES \$352.3 million

EARNINGS \$49.2 million

WHAT'S HOT Farmers as far away as China and South Africa have cottoned to the company's weed- and pest-resistant genetically modified seeds.

● **CEO ROBINSON:** AFTER A FAILED DEAL, HIS COMPANY MAY BE TAKEOVER BAIT

HIS COTTON IS NO PUFFBALL

The U.S. king of genetically altered cottonseed finds a big market overseas for its pricey but resilient seed

When Murray Robinson joined Delta & Pine Land Co. in 1988 as executive vice-president, the 18-year veteran of the agricultural seed business made a curious discovery: With exception of the CEO, no one at the company—named for the rural Delta Piney Woods area of Mississippi where it is based—owned a passport. Because the 77-year-old cottonseed company sold only to U.S. farmers, nobody needed one. But Robinson, now 67 and, says he soon realized that “for this company to grow long-term, it would have to participate globally.”

His well-worn passport now bears stamps from China (the company's most important foreign market), Australia, Turkey, and many of the 13 other nations where Delta sells its popular herbicide-tolerant, insect-resistant genetically modified cottonseed as well as conventional seed. Overseas sales account for 10% of revenues and are growing 35% annually. And international business is so strong that Delta, No. 42 on the Hot Growth list, has had to start building a special management group with experience in foreign cultures. The company's global outlook has helped generate an average 20% annual rise in sales over the past three years and a 142% average annual rise in profits. Meanwhile, Delta already has a lock on the U.S. market, with an 85% share of sales of genetically altered cottonseed.

The genetic material in those seeds

was developed by Monsanto Co. But it is Delta seeds that carry the benefits of altered genes to the farmer. The relationship between the two companies continues even after a merger agreement fell apart in 1999 when Monsanto, says Delta, rejected changes that the Justice Dept. required to approve the deal. Monsanto paid Delta an \$81 million breakup fee, but Delta is still suing Monsanto for \$2 billion, charging breach of contract. The companies continue to do business because it is mutually beneficial. Delta gets the genetic material and Monsanto receives a cut of the revenue when farmers buy the seed. “It really has not impeded the progress of business,” says Robinson. Monsanto will keep working with Delta, but says it also expects to win the lawsuit.

“ENVIRONMENTALLY FRIENDLY.” The company's altered cottonseed costs three to four times as much as conventional seed. But it pays for itself in savings on herbicide, insecticide, and even fuel, since farmers make fewer trips to inspect or spray crops. Kenneth Hood, whose Gunnison (Miss.) family grows 10,000 acres of cotton, says the savings add up to \$40 per acre. Plus, he says, “the seeds are more economically feasible and environmentally friendly.” And, he could add, less controversial than genetically modified foods; cotton isn't eaten.

Still, analysts believe that Delta's biggest opportunities are abroad, where farmers crave Delta's pest-resistant seeds. In China, the world's third-largest cotton producer, Delta's seeds are already used by more than one million farmers—even though they're sold through joint ventures in only two of China's 23 provinces. “In the absence of biotechnology, this would not be a growth story,” says analyst Daniel Ellefson of Security Investment Co. of Kansas City.

The only downside analysts see for Delta could become an upside for investors: With Delta's share price down to around \$22, from the \$54 reached three years ago, the company is now vulnerable to a takeover bid, perhaps by a European biotech firm. “It is a class-A takeover target,” says Guy Wyser-Pratte, a New York money manager who holds 1.4 million Delta shares. But Robinson doesn't worry about that. “We don't try to envision what we'll be like in 10 years, because we're not that smart,” he says. He just watches over business from Delta's incongruously sleek Art Deco headquarters—and keeps his passport ready.

By Aixa M. Pascual
in Scott, Miss.





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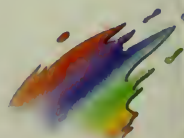
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HOT GROWTH COMPANIES

to win a position in this table, a company must excel in three areas. The selection process begins by ranking companies according to their three-year results in sales growth, earnings growth, and return on invested capital. Ranks in the table are calculated from these numbers. A company's composite rank is the sum of its three ranks, divided by 3.5 times its rank in return on capital plus 0.25 times each of its growth ranks.

Standard & Poor's Institutional Market Services, a division of The McGraw-Hill Companies, which computerized financial data

on approximately 10,000 publicly traded corporations, provided the pool of companies from which winners were selected. To qualify, a company must have annual sales of more than \$50 million and less than \$1.5 billion, a current market value greater than \$25 million, a current stock price greater than \$5, and be actively traded. Banks, insurers, real estate firms, and utilities are excluded. So are companies with declines in current financial results or in stock price, as well as companies where other developments raise questions about future performance.

SALES and EARNINGS are the latest figures available through the most recent 12 months. Earnings include net income from continuing operations before gains or losses from extraordinary items.

INCREASES in SALES and PROFITS are calculated using the least-squares method. If results for the earliest year are negative or not available, the average is for two years.

RETURN ON CAPITAL is earnings plus minority interests expressed as a percent of total debt and equity. For ranking purposes,

the maximum allowable annual return on invested capital is 100%. If companies have made substantial accounting restatements, long-term returns may be averaged for two years instead of three years.

Time periods vary according to the month of a company's fiscal yearend. Profitability and growth are calculated based on the most recently available data.

STOCK PRICE data are as of May 10, 2001. A ● indicates that a company also appeared in last year's rankings (BW—May 29, 2000).

COMPANY (STOCK SYMBOL)	CURRENT RESULTS		THREE-YEAR AVERAGES			INVESTMENT DATA			
	SALES \$ MIL.	EARNINGS \$ MIL.	INCREASE (%)		RETURN ON CAPITAL	STOCK PRICE		P-E RATIO	MARKET VALUE \$ MIL.
OPTICAL COMMUNICATION PRODUCTS (OCPI) Chatsworth, Calif. 818 701-0164 Maker of fiber optics, telecommunications hardware	151.6	38.7	127.9	161.9	47.8	23-6	12	33	1311
DIRECT FOCUS (DFXI) Vancouver, Wash. 360 694-7722 ● Direct marketing of Bowflex, Nautilus, and other sports gear	251.4	47.4	122.8	146.5	51.1	36-13	32	16	764
IXIA (XXIA) Calabasas, Calif. 818 871-1800 Designer of optical interface cards and related software	93.7	11.4	293.3	399.5	27.1	39-10	17	89	914
AREMISSOFT (AREM) Westmont, N.J. 856 869-0770 Enterprise resource planning software for mid-sized companies	141.3	34.7	42.5	220.9	33.5	28-9	18	18	687
CORPORATE EXECUTIVE BOARD (EXBD) Washington, D.C. 202 777-5000 Business research and analysis by subscription	103.9	16.3	35.0	152.7	61.4	47-24	34	74	1065
CHICO'S FAS (CHS) Fort Myers, Fla. 941 277-6200 ● Exclusive label: women's fashions and accessories	259.4	28.4	50.4	111.9	27.1	32-11	31	29	804
ALBANY MOLECULAR RESEARCH (AMRI) Albany, N.Y. 518 464-0279 ● R&D for pharmaceutical and biotechnology companies	66.6	23.6	79.6	107.9	25.5	71-21	34	45	1111
CHILDREN'S PLACE RETAIL STORES (PLCE) Secaucus, N.J. 201 558-2400 ● Togs for tots to pre-teens	587.4	42.7	45.4	81.5	26.8	36-15	29	18	740
SKECHERS U.S.A. (SKX) Manhattan Beach, Calif. 310 318-3100 ● Funky shoes for casual wear	769.2	54.1	49.7	51.0	37.6	38-11	37	26	1327
POLYCOM (PLCM) Milpitas, Calif. 408 526-9000 Video- and audio-conferencing devices	360.2	44.0	90.9	82.6	22.4	72-11	25	44	1867
CABOT MICROELECTRONICS (CCMP) Aurora, Ill. 630 375-6631 Makers of slurries used in polishing integrated circuit devices	231.1	42.4	72.1	244.0	19.3	100-28	65	37	1534
TOPPS (TOPP) New York 212 376-0300 Bubble gum, plus trading cards, stickers, and comics	439.3	88.5	25.6	138.4	38.1	12-8	10	5	456
AMERICAN EAGLE OUTFITTERS (AEOS) Warrendale, Pa. 724 776-4857 Casual apparel and accessories for young men and women	1093.5	93.8	39.4	68.6	31.3	43-8	41	32	2836
FRONTIER AIRLINES (FRNT) Denver 303 371-7400 Denver-based budget airline with 25 Boeing 737s	450.6	53.8	45.6	32.7	47.0	26-8	15	8	411
ABERCROMBIE & FITCH (ANF) Reynoldsburg, Ohio 614 577-6500 Upscale sport clothes and accessories	1237.6	158.1	32.8	48.3	46.8	38-8	38	24	3715
CHRISTOPHER & BANKS (CHBS) Minneapolis 763 551-5000 ● Corporate dress for the working woman	209.2	25.5	28.3	81.8	27.5	43-9	41	27	596
NVIDIA (NVDA) Santa Clara, Calif. 408 615-2500 High-definition 2-D and 3-D graphics processors	735.3	99.9	187.3	391.9	16.9	95-28	80	64	5489
MICREL (MCRL) San Jose, Calif. 408 944-0800 ● Designs and markets analog and mixed-signal integrated circuits	320.0	74.4	45.0	70.9	22.2	79-23	36	45	3044

HOT GROWTH COMPANIES

COMPANY (STOCK SYMBOL)	CURRENT RESULTS		THREE-YEAR AVERAGES			INVESTMENT DATA			M. V. \$
	SALES \$ MIL.	EARNINGS \$ MIL.	INCREASE (%) SALES	PROFITS	RETURN ON CAPITAL	STOCK PRICE 52-WEEK HIGH - LOW	RECENT	P-E RATIO	
19 INNODATA (INOD) Hackensack, N.J. 201 488-1200 Data conversion for electronic publishers and ICPs	60.0	8.6	36.5	65.6	25.3	9-1	6	16	
20 PROFESSIONAL DETAILING (PDII) Upper Saddle River, N.J. 201 258-8450 Sales and marketing services for pharmaceutical companies	518.7	32.3	94.3	68.7	18.8	142-26	82	35	1
21 MEASUREMENT SPECIALTIES (MSS) Fairfield, N.J. 973 808-1819 ● Electronic scales, pressure gauges, distance-measuring devices	95.4	8.1	49.4	126.9	18.2	31-11	24	26	
22 HOT TOPIC (HOTT) Rowland Heights, Calif. 626 839-4681 ● Hip wearables and accessories for young men and women	257.2	23.2	54.8	77.0	18.4	36-10	33	31	
23 AMERICA SERVICE GROUP (ASGR) Brentwood, Tenn. 615 373-3100 ● Managed health care for correctional institutions	443.7	8.5	51.1	55.1	20.3	29-15	24	16	
24 TAKE-TWO INTERACTIVE SOFTWARE (TTWO) New York 212 334-6633 Fun and games: for Nintendo, Sony, and Sega consoles	395.3	27.9	158.8	90.4	17.0	17-8	16	18	
25 JACK HENRY & ASSOCIATES (JKHY) Monett, Mo. 417 235-6652 Integrated hardware and software systems for banks	319.9	51.5	41.9	31.2	26.2	33-18	27	47	23
26 RENAISSANCE LEARNING (RLRN) Wisconsin Rapids, Wis. 715 424-3636 A stake in the future: software for schools K-12	113.1	24.1	44.6	33.4	22.8	48-13	39	56	13
27 STEVEN MAOGEN (SHOO) Long Island City, N.Y. 718 446-1800 ● Cool shoes, shades, and must-haves	219.4	16.5	53.8	83.9	17.1	22-6	16	12	
28 FACTSET RESEARCH SYSTEMS (FDS) Greenwich, Conn. 203 863-1500 ● Online investment-related databases and applications	155.2	28.6	31.9	42.0	24.4	44-18	39	47	17
29 FOSSIL (FOSL) Richardson, Tex. 972 234-2525 ● A stitch and time: fashions and watches	504.3	55.9	28.3	45.1	25.0	22-11	19	11	
30 PEC SOLUTIONS (PECS) Fairfax, Va. 703 679-4900 A total solutions provider for e-government	74.6	8.3	28.4	27.8	31.0	22-4	19	56	
31 RESMED (RMD) Poway, Calif. 858 746-2400 ● Rest easy: It has solutions for obstructive sleep apnea	139.7	9.5	33.0	44.6	22.3	59-20	56	186	17
32 WATERS (WAT) Milford, Mass. 508 478-2000 Its instruments separate and identify chemicals	815.5	164.2	19.0	44.9	29.0	91-32	51	43	60
33 KEITH COS. (TKCI) Costa Mesa, Calif. 714 540-0800 Engineering and consulting services	57.6	5.3	35.3	68.9	18.6	26-3	16	17	
34 AAON (AAON) Tulsa 918 583-2266 ● Commercial and industrial cooling and heating systems	159.0	13.3	23.4	64.0	22.2	28-16	21	9	
35 CHARLOTTE RUSSE HOLOING (CHIC) San Diego 858 587-1500 Mall bargains for younger women	292.1	23.0	43.1	61.0	18.1	37-8	35	35	
36 APOLLO GROUP (APOL) Phoenix 480 966-5394 Teaching old dogs new tricks: educational programs for adults	672.7	83.6	29.7	28.6	25.1	40-17	37	51	43
37 BARRA (BARZ) Berkeley, Calif. 510 548-5442 Risk and valuation models by subscription	224.4	45.3	17.8	79.0	21.9	62-24	45	22	
38 SERENA SOFTWARE (SRNA) Burlingame, Calif. 650 696-1800 ● Chaos control: software to facilitate upgrades of mainframes	103.6	24.3	48.5	74.7	15.7	58-5	21	35	
39 CONVERSE TECHNOLOGY (CMVT) Woodbury, N.Y. 516 677-7200 Its service systems make call-waiting and voice-mail possible	1225.1	249.1	59.2	76.1	14.1	125-45	74	54	12
40 CATALINA MARKETING (POS) St. Petersburg, Fla. 727 579-5000 ● Bull's-eye! Target marketing for manufacturers and retailers	417.9	58.1	25.2	22.4	28.0	45-24	33	33	18
41 BEL FUSE (BELFB) Jersey City, N.J. 201 432-0463 Transformers and electronics for telecommunications	152.8	35.3	26.1	52.4	19.3	45-16	30	9	
42 DELTA & PINE LAND (DLP) Scott, Miss. 662 742-4000 Top seeded: soybeans and cottonseed	352.3	49.2	19.6	141.7	18.2	29-19	22	18	
43 MERCURY INTERACTIVE (MERQ) Sunnyvale, Calif. 408 822-5200 ● Web-management products to ensure speedy, error-free sites	337.3	71.1	58.4	105.8	13.2	163-31	63	81	5
44 MERCURY COMPUTER SYSTEMS (MRCY) Chelmsford, Mass. 978 256-1300 High-speed digital signals for defense and medical imaging markets	167.1	26.6	29.2	73.2	17.3	56-17	48	41	10
45 MAXIMUS (MMS) Reston, Va. 703 251-8500 ● Management services for governmental agencies	449.5	32.8	45.2	56.0	15.7	40-18	35	23	
46 SEMTECH (SMTC) Newbury Park, Calif. 805 498-2111 ● Makes analog and mixed-signal semiconductors	256.7	60.2	37.2	65.6	16.3	60-15	31	39	2
47 APPLIED INNOVATION (AINN) Dublin, Ohio 614 798-2000 Hardware, software, and services for telecommunications	127.4	10.8	30.4	109.6	15.5	28-6	14	21	
48 AVANT (AVNT) Fremont, Calif. 510 413-8000 Automation software for advanced integrated circuits	366.5	48.6	34.4	101.4	14.9	27-12	17	14	



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HOT GROWTH COMPANIES

COMPANY (STOCK SYMBOL)	CURRENT RESULTS		THREE-YEAR AVERAGES			INVESTMENT DATA			
	SALES \$ MIL.	EARNINGS \$ MIL.	INCREASE (%) SALES	PROFITS	RETURN ON CAPITAL	STOCK PRICE		P-E RATIO	M V \$
49 MAXIM INTEGRATED PRODUCTS (MXIM) Sunnyvale, Calif. 408 737-7600 Its chips translate real world data into digital signals	1153.6	379.2	24.0	25.2	24.9	90-34	49	41	13
50 INTEGRATED CIRCUIT SYSTEMS (ICST) Norristown, Pa. 610 630-5300 Silicon timing devices for motherboards and peripheral applications	198.2	58.5	13.4	21.1	34.8	30-10	17	19	1
51 IDEC PHARMACEUTICALS (IDPH) San Diego 858 431-8500 Develops treatments for cancer, autoimmune and inflammatory diseases	184.2	73.3	49.7	63.5	14.0	78-19	53	118	7
52 ADVANCED DIGITAL INFORMATION (ADIC) Redmond, Wash. 425 881-8004 No 18½-minute gaps: automated tape libraries for data storage	297.1	90.4	47.2	154.5	11.3	28-11	24	14	1
53 SBS TECHNOLOGIES (SBSE) Albuquerque 505 875-0600 Sky high-tech: embedded computer components for aircraft and spacecraft	179.1	12.5	35.2	147.7	13.5	38-12	21	26	
54 FASTENAL (FAST) Winona, Minn. 507 454-5374 Hardware stores catering to industrial clientele	770.5	81.4	23.1	25.3	23.0	73-45	62	29	2
55 ANSYS (ANSS) Canonsburg, Pa. 724 746-3304 ● Software for design engineers and engineering analysts	75.3	14.2	13.6	30.1	22.6	15-9	15	17	
56 SCANSOURCE (SCSC) Greenville, S.C. 864 288-2432 Everything for the checkout counter	607.6	17.0	73.1	73.7	11.5	73-26	53	19	
57 LINEAR TECHNOLOGY (LLTC) Milpitas, Calif. 408 432-1900 A broad range of linear integrated circuits for electronic applications	983.6	431.3	21.0	26.6	22.0	75-33	48	37	15
58 K-V PHARMACEUTICAL (KV.A) St. Louis 314 645-6600 ● Manufactures controlled-release and taste-masked drugs	166.3	26.1	19.8	29.1	21.4	40-13	24	29	
59 TECHNE (TECH) Minneapolis 612 379-8854 ● Clinical diagnostic products for hospitals and laboratories	112.0	33.2	20.9	31.9	19.2	80-19	34	44	1
60 FOREST LABORATORIES (FRX) New York 212 421-7850 Name brands as well as generic prescription and OTC products	1174.5	215.1	42.0	76.5	12.8	72-40	63	53	11
61 BRASS EAGLE (XTRM) Bentonville, Ark. 501 464-8700 Splat! Paintball supplies for the young and the brave	92.5	9.2	28.8	29.8	18.4	9-3	9	7	
62 PRIDRITY HEALTHCARE (PHCC) Lake Mary, Fla. 407 804-6700 Services for patients who require high-cost and complex therapies	616.5	30.1	38.1	69.4	13.6	45-21	36	53	1
63 CORINTHIAN COLLEGES (COCO) Santa Ana, Calif. 714 427-3000 For-profit colleges in 19 states	223.8	22.7	29.7	255.4	11.9	48-10	44	42	
64 DEB SHOPS (DEBS) Philadelphia 215 676-6000 Teen-targeted fashions, shoes, and necessities	287.3	24.8	12.2	55.5	18.5	23-9	21	12	
65 DOVER DOWNS ENTERTAINMENT (DVD) Dover, Del. 302 674-4600 ● Owns and operates motor-sports tracks and Vegas-style casinos	258.1	34.1	35.5	24.5	18.1	14-10	12	13	
66 METRO ONE TELECOMMUNICATIONS (MTON) Beaverton, Ore. 503 643-9500 Need directory assistance for your cell phone? Just call on Metro	177.5	13.6	80.9	66.8	10.0	45-9	45	43	
67 DEVRY (DV) Oakbrook Terrace, Ill. 630 571-7700 "Career-oriented" technical and business schools	558.7	55.7	18.1	25.6	21.2	42-23	30	38	2
68 MTR GAMING GROUP (MNTG) Chester, W. Va. 304 387-5712 Place your bets at any of the three MTR gaming resorts	182.9	16.1	41.0	36.3	14.8	9-3	8	14	
69 ZEBRA TECHNOLOGIES (ZBRA) Vernon Hills, Ill. 847 634-6700 ● Bar-code labeling printers	498.1	73.3	34.0	23.3	17.9	58-34	44	19	
70 NOVELLUS SYSTEMS (NVLS) San Jose, Calif. 408 943-9700 Solutions for problems in semiconductor manufacturing	1412.5	294.0	28.4	111.2	12.5	70-25	49	24	6
71 SCP POOL (POOL) Covington, La. 504 892-5521 Dive right in! They distribute pool supplies	704.6	27.9	25.8	58.4	15.5	36-19	34	22	
72 GENTEX (GNTX) Zeeland, Mich. 616 772-1800 ● Car mirrors and products	302.9	69.2	17.0	26.3	19.5	33-16	27	29	
73 BLACK BOX (BBOX) Lawrence, Pa. 724 746-5500 Manufactures, sells, and installs switches, cables, and converters	827.0	64.2	44.3	27.6	14.8	92-39	62	19	
74 C&D TECHNOLOGIES (CHP) Blue Bell, Pa. 215 619-2700 Its batteries empower everything from telephones to forklifts	615.7	55.9	28.0	39.7	16.1	62-23	35	17	
75 MAPINFO (MAPS) Troy, N.Y. 518 285-6000 Mapping and geographic info systems; can locate and verify addresses	108.6	9.9	26.2	849.0	10.2	53-15	32	49	
76 TOTAL SYSTEM SERVICES (TSS) Columbus, Ga. 706 649-2310 Credit card processor for banks and private-label plastic issuers	609.6	87.0	19.9	22.1	19.2	29-15	28	64	
77 ADVANCED MARKETING SERVICES (MKT) San Diego 858 457-2500 Books, CD-ROMs, and videocassettes for warehouse clubs	713.6	20.8	18.5	31.9	17.5	18-10	18	17	
78 ADVENT SOFTWARE (ADVS) San Francisco 415 543-7696 Investment management and accounting software	144.0	27.9	40.8	71.8	10.2	77-30	52	63	

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COMPANY (STOCK SYMBOL)	CURRENT RESULTS		THREE-YEAR AVERAGES			INVESTMENT DATA			
	SALES \$ MIL	EARNINGS \$ MIL	INCREASE (%) SALES	PROFITS	RETURN ON CAPITAL	STOCK PRICE 52-WEEK HIGH - LOW	RECENT	P-E RATIO	MA \$
79 DAL-TILE INTERNATIONAL (DTL) Dallas 214 398-1411 Often underfoot: a maker of ceramic tiles	967.6	95.9	12.2	104.8	13.9	17 - 7	15	9	8
80 MEN'S WEARHOUSE (MW) Houston 713 592-7200 You'll like the way you look in its professional and casual clothes	1333.5	84.7	30.7	42.5	13.9	34 - 17	24	12	10
81 TETRA TECH (TTEK) Pasadena, Calif. 626 351-4664 Green knowhow: environmental consulting and technical services	676.9	44.7	46.2	41.5	10.5	38 - 16	28	26	17
82 PATTERSON DENTAL (PDCO) St. Paul 651 686-1600 It supplies the latest in dentistry technologies and products	1123.2	73.4	13.5	22.4	19.0	35 - 19	31	29	20
83 OCULAR SCIENCES (OCLR) South San Francisco 650 583-1400 ● Distributes soft contact lenses to eye-care professionals	190.1	36.6	14.4	23.1	18.7	20 - 11	17	11	4
84 QUIKSILVER (ZQK) Huntington Beach, Calif. 714 889-2200 Surf and turf clothing and accessories for the young generation	541.8	31.5	31.5	37.2	13.7	29 - 11	27	20	6
85 CARREKER (CANI) Dallas 972 458-1981 ● Provides software solutions for banks	110.3	13.6	39.5	63.3	10.4	41 - 8	18	26	3
86 RENAL CARE GROUP (RCGI) Nashville 615 345-5500 Dialysis and related nephrology services	647.7	54.3	42.6	37.1	11.2	30 - 15	26	23	12
87 F.Y.I. (FYII) Dallas 214 953-7555 Information management and document processing	471.2	33.6	43.6	49.9	9.6	43 - 27	38	18	6
88 99 CENTS ONLY STORES (NDN) City of Commerce, Calif. 323 980-8145 ● More bang for the buck! General merchandise at 99¢ or less	476.1	40.8	23.7	27.1	15.9	37 - 14	28	36	14
89 GROUP 1 SOFTWARE (GSOF) Lanham, Md. 301 918-0400 Software for mass mailings	91.8	8.3	15.6	94.4	12.0	23 - 10	13	11	
90 NEW HORIZONS WORLDWIDE (NEWH) Santa Ana, Calif. 714 432-7600 Teaching the ins-and-outs at computer training centers	149.8	11.1	40.8	42.5	10.2	26 - 11	15	14	
91 DAKLEY (OO) Foothill Ranch, Calif. 949 951-0991 Designs and manufactures eyewear, footwear, and athletic accessories	394.2	54.7	22.0	30.7	15.1	24 - 10	23	29	15
92 GREEN MOUNTAIN COFFEE (GMCR) Waterbury, Vt. 802 244-5621 Coffee wholesaler	90.2	4.7	20.2	70.2	12.4	33 - 6	33	49	
93 QUIXOTE (QUIX) Chicago 312 467-6755 Makes highway safety and traffic-control devices	92.5	9.9	23.5	42.9	13.5	28 - 13	28	22	
94 REHAB CARE GROUP (RHB) St. Louis 314 863-7422 Clara Barton wannabes: staffing for health-care facilities	477.2	25.1	42.0	28.9	11.8	53 - 15	38	25	
95 ORTHODONTIC CENTERS OF AMERICA (OCA) Ponte Vedra Beach, Fla. 904 280-4500 Dental practice management firm in the U.S., Japan, and Mexico	280.6	47.5	31.9	29.1	13.2	35 - 17	27	28	1
96 CEC ENTERTAINMENT (CEC) Irving, Tex. 972 258-8507 Five stars from the grade-school set: It runs Chuck E. Cheese	527.7	61.8	13.5	29.7	16.2	54 - 22	51	23	1
97 WEST (WSTC) Omaha 402 963-1200 Outsourced teleservices, automated voice and data-processing centers	757.5	75.1	21.5	21.8	16.3	31 - 18	26	24	1
98 BARR LABORATORIES (BRL) Pomona, N.Y. 845 362-1100 ● Develops and manufactures generic and proprietary drugs	495.6	59.8	19.4	32.9	14.2	80 - 29	56	44	1
99 SYMANTEC (SYMC) Cupertino, Calif. 408 253-9600 The software security market is its forte	790.2	123.0	12.4	26.2	16.5	73 - 27	66	35	5
100 DAKTRONICS (DAKT) Brookings, S.D. 605 697-4000 It knows the score: shot clocks, scoreboards, and game timers	137.3	8.2	25.6	35.4	13.2	27 - 9	26	30	

ALPHABETICAL INDEX OF COMPANIES

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MUSIC

MOANIN' THE BLUES IN NASHVILLE

Why country music sales are in such a funk

*For the steel guitars no longer cry
And the fiddles barely play
But drums and rock 'n' roll guitars
Are mixed up in your face
Ol' Hank wouldn't have a chance
On today's radio
Since they committed murder
Down on Music Row
—Murder On Music Row*

Country singers George Strait and Alan Jackson first teamed up to perform that song last year, and its message rings true as ever. Nashville may have a brand new Country Music Hall of Fame, complete with windows that look like piano keys and a replica of a radio tower, but country music, which commanded nearly 19% of all record sales in 1993, is going down faster than a bottle of Jack Daniels at a hoedown.

Like all music genres, country has had its ups and downs, beginning when Elvis Presley first gyrated onto the pop scene in the early '50s. But this dip looks like more than a cyclical downturn. Since the mid-1990s, country music sales have been plunging, by as much as 23% last year, to \$1.5 billion, according to the

Recording Industry Association of America. Radio audiences have shrunk over five years by 75% in some unlikely markets, including Birmingham, Ala., and San Antonio. Some big country stations, such as New York's WYNY, are struggling.



THE INDUSTRY SHIFTED TO THE GLITZ OF SHANIA TWAIN

Record companies Atlantic and Virgin have closed their country labels in the past six months. And country music revenue is off 30% in the past year, say record executives and artists' agents. Worries 75-year-old legendary country guitarist Hank Bradley: "This is the worst I've seen in a long time—maybe ever."

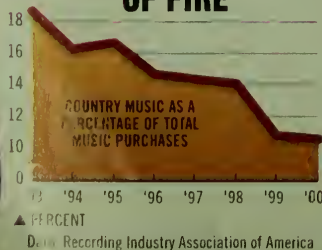
TRADING UP. So what's happening to the music once defined by the twang and heartache of Hank Williams, Johnny Cash, and Patsy Cline? Experts say the falloff can largely be blamed on the blurring of the lines between country and pop music with overtly sexy acts like Faith Hill and Shania Twain moving in on more traditional artists like Tammy Wynette and Emmylou Harris. This shift from bolo ties to bellybutton rings has cost country music legions of fans, who yearn for roots-based music without the production and glitz.

To make matters worse, more of country's traditional core listeners—rural, blue-collar, white, and largely female—have traded up for the suburbs during the recent economic boom. William Wade, a Tennessee-based economist who studies demographic trends, says new suburbanites, fearing they be stereotyped as "hayseeds," often switch to pop. Then there's a decline by 5% during the 1990s, in the population that spends the most on music: whites from ages 25 to 34. Meanwhile, Hispanics of the same age group surged 21%; these days Ricky Martin outsells any single country artist, including pop crossover act Dixie Chicks.

Country music has also been hit by the consolidation of radio stations into a handful of conglomerates over the past five years. The 2,000-plus country music stations still outnumber

BUT FANS YEARN FOR SIMPLER ACTS LIKE EMMYLOU

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ber any other genre, but their owners are programming more commercials and mainstream fare. Many longtimers doubt that today's young radio programmers—or label execs for that matter—know how to reach the country faithful. There are few country specialists, with most radio execs programming several genres at the same time. They're "converts from Top 40 radio," laments Danny Davis, a producer and musician who introduced horns to country in the 1960s. Stations that are part of media chains are more likely to play it safe, airing superstars such as Hill. "It's harder to break new acts," says Denise Nichols, director of radio promotion at Nashville talent agency TBA Entertainment.

"HAT CLONES." But some of the decline in country music can be blamed on the industry itself. During the last peak, it piled on "hat clones" of Garth Brooks. When Brooks introduced the pyrotechnics of rock 'n' roll music, he won millions of new fans, including 250,000 at a landmark concert in New York's Central Park in 1997. "The labels thought all they had to do was find new Garths," says Ed Shane, owner of consultancy Shane Media in Houston. And they did, with a vengeance. As the stars drew wider audiences, they left for the bigger playing field of pop radio. Many new listeners went with them.

Swept up by its own successes, country fell victim to overexpansion. By 1995 there were 26 country labels and 50 recording studios in Nashville—far more than the industry could ever hope to support long term. Yet with all these new properties, the industry's greatest sin has been a failure to be innovative. Insiders say five songwriters are producing most of the music, 80% of which is put out by four producers. That clique has produced a homogenous, more pop-like sound, increasingly garnering the scorn of fans, who are showing up at concerts with signs saying "Nashville Sucks."

The sales decline has hit Nashville hard. Five studios have closed in the past two years, and scores of top-flight studio musicians are out of work. "I haven't done a country recording in nine months," says Carl Tatz, who runs the independent studio Recording Acts. Tatz once booked the likes of Alan Jackson and Randy Travis for a month at a time. Now he feels he's lucky to book a little-known Christian band for four days. For artists like Mandy Barnett, a 25-year-old newcomer who considers Patsy Cline a major inspiration, it's a struggle to get her music played. She's sticking it out with "gritted teeth," Barnett says, but how soon till she's just another casualty on Music Row?

By Charles Haddad in Nashville

Social Issues



COMMENTARY

By Alexandra Starr

IS THE SAFETY NET RECESSION-READY?

Federal Reserve Chairman Alan Greenspan is doing his level best to yank the U.S. economy out of its funk. So far, gross domestic product still seems to be rising, and the jobless rate remains relatively tame. Slower hiring and more layoffs haven't yet caused severe economic pain for most American families. But if the slowdown drags on or turns into a full-blown recession, more people will turn to the social safety net for support.

So how much help can Americans count on if times turn bad? While a few federal programs have been beefed up in recent years, the broad

shift in the nation's approach to social welfare aid in the 1990s has carved new holes in the biggest programs, such as welfare, Medicaid, and food stamps (table, page 134). They now are less generous, and some include lifetime limits that could leave needy families with little recourse if jobs can't be found. New rules also make qualifying more difficult for many immigrants, whose ranks have ballooned in the past decade. Add to that soaring numbers of illegal immigrants, who never qualified in the first place and more people could go needy down the road.

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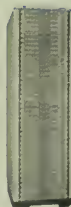


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leaner, meaner approach to social programs. True, the tougher philosophy has worked relatively well in the low-unemployment era of the past half-decade. Since welfare was overhauled in 1996, the focus has been on "making work pay," which means prodding recipients to get a job—and easing their tax burden once they're employed. This has brought a big boon to the working poor in the form of tax breaks, through an expansion of the Earned Income Tax Credit. The tough new rules sped the process along by pushing welfare mothers off the rolls and into the waiting arms of employers.

The hitch, of course, is that you have to draw a paycheck to qualify. The 1996 welfare law created the Temporary Assistance for Needy Families (TANF), which placed a five-year lifetime limit on individuals' ability to get federal benefits. The caps don't kick in until next year in most states, so few welfare mothers have run into problems yet. But those who can't land a job in a weaker labor market could be dropped from the rolls as they reach the limit.

INADEQUATE. TANF also has given states more leeway in how they administer welfare, which could cause problems, too. Welfare is now a block grant, not an entitlement. That is, Uncle Sam forks over a set amount of TANF money to states, whose allotments don't rise if more mothers need help. So if the rolls swell in a downturn, states will be stuck with the tab. They are allowed to exempt 20% of their caseloads from the time restrictions. They also can dip into their own pockets after federal funds run out. Already, some states are salting away current surpluses, and there is a federal contingency fund that could provide some additional money. But, cautions Isabel Sawhill of the Brookings Institution, "by most analyses, these provisions would not be adequate in a typical-sized recession."

Food stamps, too, are harder to come by now. The 1996 welfare law barred most legal immigrants from collecting food aid. It also slapped limits on able-bodied adults without dependents, who now get only three months of food stamps in any three-year period, unless they are working. Seventeen states have ponied up their own funds to give food stamps to immigrants. And 38 have obtained waivers to skirt the three-month limit. Still, the new rules will leave more families without food assistance if

a recession drives up hunger. But it may be worse than it needs to be. That's because the new rules ended up confusing a lot of folks. The welfare rolls have fallen in half, to 2.2 million families, since 1996.

IF THE JOBLESS RATE KEEPS CLIMBING...



Data: Bureau of Labor Statistics

...MORE PEOPLE MAY SLIP THROUGH THE CRACKS

UNEMPLOYMENT INSURANCE At least 22 state programs have let their unemployment insurance reserve funds run down, which could cause a clampdown on eligibility rules just as more workers need help. There are also more low-wage temps and part-timers, who are less likely to be covered.

WELFARE The 1996 welfare-to-work law imposed a five-year lifetime limit on federal benefits, so more mothers could be without recourse if they can't find work. The law also cut immigrants' access to the program, as well as to food stamps and Medicaid.

FOOD STAMPS Millions of families aren't getting help, in part because welfare reform confused people about eligibility. New rules could fix the problem, but it may be a while until word gets out.

MEDICAID Welfare reform confusion also led to fewer eligible families getting aid, although states now seem to be doing a better job of covering them.

STATE CHILDREN'S HEALTH INSURANCE PROGRAM The one bright spot, CHIP, which covers low-income kids, has enrolled 3.3 million children since it started in 1997.

But many former recipients earn poverty-level wages, entitling them to continue to collect food stamps and to get health coverage through Medicaid. Yet many families don't seem to realize that. The number of people getting food stamps has plunged by one-third, to 17 million, since 1996. Today, fewer than half of eligible working families actually collect them, according to the Center for Budget & Policy Priorities, a Washington think tank. Similarly, the share of poor parents with Medicaid has fallen, even as their uninsured rate has jumped.

IN THE COLD? Recent efforts could help to get qualifying families back on board. Last fall, Congress passed new rules that allow states to make it easier for former welfare recipients to stay on food stamps. But if people remain confused, higher unemployment could compound the problem. Some states, meanwhile, have been trying to address the Medicaid underenrollment. "The hemorrhaging appears to have been stanchied, but there's still a significant problem," says Ron Pollack, head of Families USA, a health-care advocacy group in Washington.

Unemployment insurance may not cover as many in the event of more joblessness, either. One problem is that to qualify in many states, unemployed workers must have earned certain minimum amounts over the prior 12 months or so. This has the effect of cutting out many temp workers and part-timers, who typically have lower hourly pay rates and don't work enough hours in a year. And there are a lot more of these people since the last recession in 1991: The ranks of temps have nearly tripled, to 3 million.

A program that's actually catching a large group in need is the State Children's Health Insurance Program, which Congress passed in 1996 to expand health coverage for children of families who earn too much to qualify for Medicaid but can't afford private insurance. It has enrolled 3.3 million kids so far.

With any luck, the economy will pick up again, and few families will find themselves in need of aid. But the economy stalls, the government helping hand may not reach as far as it did in the last downturn.

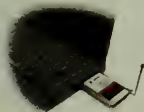
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IS THE EPA SANDBAGGING BUSINESS?

Billions are at stake in a switch in clean-air enforcement that the White House will review

In the waning years of the Clinton Administration, the Environmental Protection Agency surprised eight big utilities by declaring that previously ignored plant modifications violated the Clean Air Act. Working with the EPA, the Justice Dept. and several Northeastern states eager to cut pollution levels sued for billions of dollars in penalties. Now, in the face of an impending energy crisis—and with friends in high places—those utilities that did not settle or that reached tentative settlements with the EPA are hoping that a review by the Bush White House may make the agency back off.

That has ignited a debate that reaches far beyond utilities and refiners, affecting businesses from paper mills to chipmakers. Industry says that unless the EPA changes its strict interpretation of the rules, innovation and efficiency in power plants and factories will

remain stalled. Even before the November election, utilities and others have been pushing for a new approach to regulating air pollution to end this impasse. The basic idea: Instead of requiring companies to install costly pollution controls when they make "significant modifications" to their facilities—a hard-to-define criterion—regulators would set general emissions-reduction goals and give industry flexibility to meet them. The current rules have "been very, very destructive as far as what changes manufacturers feel they can make to their facilities," says Jeffrey Marks, director of air quality at the National Association of Manufacturers. "It is very important to establish more simplicity to a process that has gotten out of control."

To environmentalists and many at the EPA, these companies have been skirting the law, making America's air dirtier

than it has to be. To the companies, EPA gave them a green light and handed them a traffic ticket.

Case in point: Virginia Power. In 1988, the utility needed to make repairs to its coal-fired plant in northeastern West Virginia. A crucial bundle of tubes used to generate steam in one of the plant's three units was about to wear out. Virginia Power, a utility energy giant Dominion Resources Inc., Richmond, Va., says it checked with EPA to ensure such changes were in compliance with the law. "We were fine because they were routine maintenance," says James Sanderlin, Dominion's chief counsel.

Fast-forward to summer, 2000. A decade after Virginia Power made the change, the EPA told the company it was in violation of the Clean Air Act. The modifications at the aptly named Mount Storm Power Station were



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Government

extensive, the EPA said, that the company should have applied for a Clean Air permit—and, more important, spent big bucks to cut emissions.

At the center of the Virginia Power case and the entire debate is a seemingly arcane provision of the Clean Air Act known as “new source review,” which requires companies to get a permit from the EPA and typically meet strict emissions standards when they make a “significant modification” to an existing plant. Trouble is, what constitutes a “significant modification” is not clearly defined. Until the late 1990s, the EPA took a conservative approach, routinely ignoring the replacing of pipes and other equipment in power plants.

UNDER THE RADAR? But EPA regulators came to believe that America's air wasn't getting clean fast enough. In a 1997 memo, the agency laid out a new strategy to “aggressively pursue” emissions reductions. The problem, the memo said, was that the utility industry “has largely avoided installing costly pollution controls... Thirty-year-old plants are operating longer...yet few (if any) have ever admitted to ‘modifications.’” The result: The agency charged that utilities had broken the law by making major changes

without also making the emissions reductions required under the new source-review provisions—and filed the 1999 lawsuits.

Environmentalists argue that bringing scores of older plants—those grandfathered under the Clean Air Act—into compliance with a strict interpretation of the new source review rules would improve public health. According to a study released last fall by the Boston-based Clean Air Task Force, pollution from U.S. power plants causes some 30,000 premature deaths a year. While overall emissions have been reduced since the 1970s, “so much more needs to be done,” says Peter W. Iwanowicz, director of environmental health at the American Lung Association of New York. Indeed, a Harvard University study released in January showed that applying modern emissions rules to seven old coal-fired plants owned by Midwest Generation would reduce the 300 deaths associated with the plants each year by two-thirds.

To industry, however, the use of the new source-review provision to try to

Dirty Air, Big Money

CINERGY

Coal-fired power plant in Indiana, Ohio cited

STATUS Tentative, \$1.2 billion settlement reached in December, 2000

knock down air pollution is a misinterpretation of the law. And it's for companies in a whole range of industries to delay improvements. “Historically, the regulations were interpreted in a common-sense manner,” says Thor R. Kuhn, president of Edison Electric Institute, a Washington lobbying group for electric utilities. “Then there was a whole new interpretation that put the rug out from under the utilities.”

In the face of this legal onslaught, there have been settlements, though not all have been finalized. Dominion reached a tentative pact with the state and the attorneys general of seven Northeastern states for \$1.2 billion in November. Likewise, Cinergy Corp. of Cincinnati has yet to finalize the \$1.2 billion settlement it reached last

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DOMINION POWER

power plants
West Virginia

entative, \$1.2 billion
reached in Novem-

MARATHON ASHLAND PETROLEUM

Petroleum refineries in
Illinois, Louisiana, Texas,
Kentucky, Michigan, Ohio,
and Minnesota cited

STATUS Reached final \$265
million settlement in May, 2001

TAMPA ELECTRIC

Coal-fired power plants in
Florida cited

STATUS Reached final \$13.5
million to \$14.5 million settle-
ment in February, 2000

DYNERGY/ILLINOIS POWER

Coal-fired power plants in
Illinois

STATUS Case still pending

Data: Environmental Protection Agency, Justice Dept.,
Office of the New York Attorney General,
Illinois Environmental Council

ber. Industry lawyers insist this
n't mean they are guilty as charged.
example, attorneys say, Dominion
going to make most of the im-
vements agreed to anyway, to meet
r provisions of the Clean Air Act.
ow that the Administration has
ed to review the issue, the action
s to the White House. Environ-
talists are worried that the indus-
friendly Bush Administration will
pret new source review in a way
helps utilities and doesn't improve
quality. They also worry that the
w of existing cases by the Attorney
eral will lead the feds to back away
enforcement actions against the
ies. "It's injecting politics into the
l process," argues David G.
kins, director of the climate center

at the Natural Resources Defense Coun-
cil. "There could be a huge weakening of
the Clean Air Act if the Bush Adminis-
tration were to reverse course."

But even EPA veterans think the old
system needs to be replaced. Deciding
whether or not a change in a plant trig-
gers the source-review rules "is a game
of trying to beat or stretch a defini-
tion," says Robert Perciasepe, who was
assistant administrator of the EPA's Of-
fice of Air & Radiation under Clinton.
"In the long haul, this isn't good for ei-
ther business or the environment."

There may be a better way. An idea
being floated both by industry and
members of Congress is to set emission
limits for a whole industry and give
each company the flexibility to meet
them in the best possible way. Two bills

have already been introduced, and more
are expected this summer. In mid-
March, for instance, a bipartisan group
of lawmakers—including the new Inde-
pendent, Senator James Jeffords of Ver-
mont—introduced a bill that would man-
date reductions of key pollutants such as
nitrogen oxides, mercury, and sulphur
dioxide. Rather than require that every
plant install the best available emissions
controls, industry would be able to meet
the limits in a variety of ways, from
installing scrubbers to trading for the
right to emit pollution. Such a change
could break the impasse over older
plants, help business, and clean up the
air at the same time.

*By Laura Cohn, with John Carey,
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COMMENTARY

By Peter Coy

ELECTRICITY: REFORMS THAT WILL SAVE MONEY

With California in an electricity crisis and other regions facing the risk of summer blackouts, politicians are warning darkly of chronic shortages.

But the real problem is not a long-term lack of generating capacity. In fact, high electricity prices are stimulating such a boom in power-plant construction that the current capacity shortage could become a glut in just a few years. According to Henwood Energy Services Inc. of Sacramento, close to 100,000 megawatts of generating capacity are under construction and another 300,000 Mw are in planning stages. Some plants won't be built. But if all of them were, and on schedule, it would increase U.S. generating capacity 50% by 2004. "This construction is way beyond what would be economic," says Richard Lauckhart, a senior project manager at Henwood.

The real problem is that while high prices are working their magic in generation, they still aren't functioning as they should in two other crucial parts of the business: the consumption and the transmission of electricity. Consumers aren't seeing the true cost of the electricity that they use. And transmission prices aren't reflecting the actual costs of getting electricity across the grid from point A to point B.

As a result, Americans could end up wasting a lot of money. They could build plants in the wrong places, where they're not needed. Or they could build too many plants when it would be more efficient to reduce peak demand by shifting consumption to other times of day.

Let's start with consumption. Today, most consumers have no incentive to turn down their air conditioners when the system is gasping to meet demand because they pay the same prices regardless of generating



HOOR POWER: Sometimes plants have to pay customers to use power off-peak

costs. The obvious solution is time-of-day pricing, in which prices are highest during hours of peak use because that's when the costliest plants must be fired up to satisfy demand.

Time-of-day pricing would encourage people to shift consumption by, say, running their dishwashers late at night. Consumers don't know it, but the overnight price for electricity at wholesale can be practically zero. Utilities and other power producers are sometimes actually forced to pay industrial customers to use electrici-

ty in the early morning hours—because it's too expensive to shut down the power plants at night. Eastman Kodak Co., for instance, got paid for consuming electricity this spring. "We love it," says Joseph Sherman, Kodak's heat-balance engineer. With time-of-day pricing, consumers would pounce on such bargains and demand would even out.

GRIDLOCK. Prices for the transmission of electricity over long distances are equally illogical. They don't rise and fall based on demand. When everyone wants to use the same power lines to get electricity from some low-cost generating plant, the congestion can ripple outward like gridlock on city streets. To prevent that, system operators have to arbitrarily deny some transactions. The solution, again, is basing prices on costs—in this case, the cost of congestion. Such a system has been used successfully since 1998 by PJM Interconnection LLC of Valley Forge, Pa., which runs the grid for Pennsylvania, New Jersey, Maryland, Delaware, the District of Columbia, and part of Virginia. New England and New York, among others, have adopted versions of PJM's system.

With congestion-based pricing, consumers in cities like New York must pay high prices for electricity because the lines delivering power to them are constantly congested. Result: Entrepreneurs are building plants close to the cities to fetch the high prices, and that itself is easing the problem. Without the clear signal provided by congestion pricing, people might build plants in places where new production doesn't really help, says Craig Glazer, PJM's regulatory affairs manager. The question, says Glazer, is: "Where do you get the most bang for the buck?"

Right now in most parts of the country, only one part of the electricity system—generation—responds to high prices. Prices must be aligned with costs for consumption and transmission as well. The market only does its work if you let it.

Coy is associate economics editor.

Time-of-day pricing would encourage people to shift consumption by, say, running their dishwashers late at night

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E-COMMERCE

WHERE THE NET DELIVERS: TRAVEL

As the economy sputters, the top sites just get stronger

A year ago, Travelocity.com Inc. CEO Terrell B. Jones remembers feeling gloomy at big e-commerce conferences. Travelocity's stock had fallen to \$15 from its peak of \$46 in March, 2000, and few analysts were talking about online travel bookings. "Travel was not even on the radar screen. They would track e-commerce and leave travel out of it," he says. "We didn't get no respect."

He's no Rodney Dangerfield now. Online travel companies Travelocity.com, Expedia, and Hotel Reservations Network, are rare e-commerce birds, indeed: All have shown the first glimmers of profitability. Even Prudential Securities analyst Mark J. Rowen, best

known for vociferous sell ratings on Amazon.com, rates Expedia and Travelocity strong buys after they reported profits, before noncash items such as stock-option expenses and depreciation, in the March quarter. Expedia Inc. made money five quarters sooner than expected, while Travelocity's profits came one quarter sooner than predicted. Travelocity and Expedia are the market share leaders, with 35% and 25%, respectively, of gross online bookings in 2000. Now, Wall Street expects the black ink to spread this year to all five top sites. "Among the public companies, all are prof-

LIGHT LOAD

Lack of overhead gives

Travelocity's CEO Jones an edge over e-tailers who need to show

profitable or will be profitable by the end of the current quarter," analyst Thomas S. Underwood of Legg Mason Inc.

That bright profit picture is driving shares of Travelocity and Expedia. Prices of both have doubled since March. And that's in spite of some worries they will be hurt by Orbitz.com, a rival site launched in June that's owned by five U.S. airlines, including giants United, American, and Delta.

Profits at Expedia and Travelocity are small for now but are expected to grow rapidly. According to researcher First Call Corp., Expedia is expected to report a \$1 million profit before noncash items this calendar year but will see earnings climb to \$23.4 million in 2002. Travelocity will see this year's expected \$3.7 million in profit before noncash items climb to \$11.3 million next year, First Call says.

Some of the best news is that online travel leaders are turning the corner by attracting more

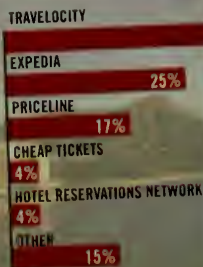
customers, not by slashing costs. "We're into profitability. We didn't shrink it," boasts Richard N. Barton, CEO of Expedia. Expedia's revenue of \$110 million was up 88% in the third quarter ended Mar. 31.

NO TRUCKS. How did travel companies beat the dot-com odds? For starters, they now capture 30% of every U.S. consumer's spend online, according to PhoCusWright, a Web travel consultancy in Sherman, Conn. Since their operations are almost entirely online. Most air travel sold online as tickets and electronic confirmation products need not be stored in warehouses or shipped. That lets the companies dodge overhead now bedeviling

THE LEADING U.S. ONLINE TRAVEL WEB SITES

BASED ON GROSS BOOKINGS 2000

Data: PhoCusWright Inc.



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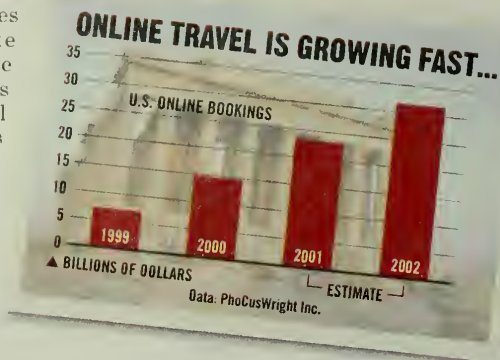
tailers. "There are a bunch of businesses that don't make sense at all on the Internet. Travel is the quintessential one that does," says Mitchell J. Rubin, a money manager at New York-based Baron Capital Inc. who has about 10% of his \$125 million fund in Internet travel companies.

Even a sluggish economy isn't likely to dampen the outlook for these Internet startups. Online travel could flourish in a tougher environment as penny-pinching travelers turn increasingly to the Web for deals. "When I travel, I always go through Internet sites," says Utah State University graduate student Catherine C. Woolley. She recently scored a \$100-a-night hotel room with a view of New York's Central Park through Priceline.com Inc., the name-your-price travel site. Such tales have analysts projecting more growth: Online travel bookings are expected to hit \$23 billion this year, up 59% over last year, according to PhoCusWright. That would represent only 10% of the travel market, leaving a vast opportunity for Internet players.

Analysts say even the arrival of Orbitz.com leaves plenty of room for the already-established online agencies to thrive. Orbitz' edge: It claims new technology will allow it to search 100,000 times as many options as other sites can search. "Orbitz will be the first travel Web site that searches 100% of the possibilities," says Orbitz CEO Jeffrey Katz. Orbitz also claims that cutting-edge technology will make it so efficient that it can pass on hundreds of millions of dollars of savings to the airlines.

LEGAL CHALLENGE. Consumer advocates and rivals are fighting regulatory approval of Orbitz, contending the airlines could use the site to more easily signal pricing moves. And competitors fear Orbitz will have access to rates that they won't get. Orbitz denies it has exclusive fares. The Transportation Dept. has given Orbitz the go-ahead, but the Justice Dept. and two dozen states' attorneys general are still evaluating it.

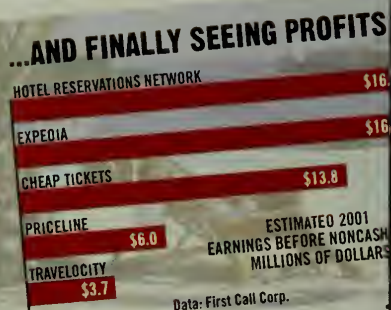
Even if Orbitz gets past regulators, it probably won't keep the Travelocity of the world from prospering. Competition is not new: Consumers already make about 60% of U.S. online air book-



ings through Web sites owned by the major carriers. And not the least of Orbitz' handicaps may be its airline owners. "Can these venom-spitting competitors called airlines really collaborate in owning a retailer?" asks PhoCusWright President Philip Wolf. Legg Mason's Underwood doesn't see where Orbitz will find many cost advantages. "We will see if they can make money, but I'd be surprised if they do," he says.

Most of all, though, the online travel agents have established their brands in a market that still has a long way to grow. Baron Capital's Rubin says leading players like Travelocity and Expedia can expand their profits 5 to 10 times over the next five years even with more competition. "They can all coexist for a long time."

Online travel agencies increased their likelihood of profitability by making smart adjustments. Even before the Nasdaq crash, they were scrambling to make their sites easier to use and to turn more lookers into bookers. Expedia, for example, has invested more than \$30 million in new technology that helps it search and price travel options. Expedia credits the changes with boosting the percentage of visitors who actually book travel to 5.7%, up from 3.8% a year ago. Travelocity's approach has been different. It launched a credit card—users earn points that can be redeemed for anything bought on the site—and started a travel club with special perks for



paying members, such as hotel-room grades and travel discounts. It has to appeal to infrequent travelers who often don't benefit from other industry loyalty programs.

Online leaders also are slashing their dependence on miserly online airline commissions, capped at \$10 a ticket. Northwest Airlines Corp. recently cut that to zero, though no rivals follow. Travelocity and Expedia are selling more vacation packages, in which

buy air tickets, hotel rooms, and travel services in bulk, then bundle them and mark them up for sale to consumers. Expedia has been able to reduce its commissions paid by airlines and hotels 25% of revenue down from 30% a year ago.

Travelocity and Expedia are getting a boost from online advertising, which is growing on most sites. Travelocity will get 25% of next year's revenue from ad sales, from likes of Holland America Cru-

se and Budget Rent a Car, Jones says. After a 221% jump in first-quarter revenue, Expedia gets about 10% of revenue from advertising and licensing, which generates gross margins of 90%.

None of this guarantees that online travel won't crash someday like the rest of the dot-coms. But as the market takes off, these skies are starting to look downright friendly.

By Wendy Zellner in Los Angeles



Expedia invested \$30 million in its site to help surfers sniff out deals—including its own travel packages

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ETA 8:45

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DAMAGED GOODS

It's an ideal market for hedge funds. But it's not so easy to raise money if you're name is John Meriwether

Wall Street groaned when supertrader John W. Meriwether, founder of busted Long-Term Capital Management, began raising \$1 billion for a new hedge fund in November, 1999. Barely 14 months earlier, LTCM had crashed and burned, losing some \$4 billion, almost dragging down world financial markets and the hedge-fund industry in its wake.

Now stripped of the two Nobel laureates and a former Federal Reserve Board vice-chairman who once worked at his side at LTCM, Meriwether is struggling. His newly minted JWM Partners has raised little more than half of its \$1 billion goal after more than a year of marketing, industry sources say. And that's when the rest of the industry is cleaning up as institutional investors rush to buy hedge funds to diversify portfolios that were painfully overinvested in big tech stocks. Total hedge-fund assets rose by \$84 billion, to \$408 billion, in 2000, according to the Hennessee Hedge Fund Advisory Group.

TRADING TOUCH. Times couldn't be better, either, for Meriwether's signature deals—profiting from very small differences between the interest rates paid on various bonds. JWM should be raising money hand over fist as the Federal Reserve cuts short-term interest rates amid doubts about economic recovery. That's because fast-paced bond market action leads to all sorts of pricing distortions that Meriwether is a wiz at exploiting. Apparently, he hasn't lost his trading touch. Although he won't reveal JWM's performance, industry sources

say its recent results were ahead of the 12% average gain for similar funds in 2000 and again beat the crowd's 2.4% average in the first four months of 2001.

The stigma from the LTCM debacle remains strong even though it repaid an emergency \$3.6 billion infusion from major banks in little more than a year by trading its way out of trouble. That capital had been supplied at the behest of the Federal Reserve Bank of New York in September, 1998, to prevent a terminal meltdown at LTCM. "He did a phenomenal job paying back the banks, but the problem is that he nearly single-handedly caused systemic problems in the market and ruined the livelihoods of everybody in the hedge-fund world," says Charles J. Gradante, managing principal of Hennessee. "The industry would be better off if he kept a low profile."

Meriwether, who in palmier days once set out to buy the rights to every known picture of himself, declined through a spokesman to be interviewed. But his need to raise money seems to have driven him from cover. In December, for example, he spoke to an association of investment professionals in the Netherlands. Then, in February, he gave a keynote speech to the Managed Funds Assn. And in May he spoke in Manhattan at a \$1000-a-head benefit for a cancer charity, the Tomorrows Children's Fund.

At the benefit, he didn't pitch JWM

CHARITY PITCH

Meriwether tells a \$1,000-per-head cancer benefit in Manhattan why hedge funds are back in style

directly, but show slide giving his address and phone number. He said that the LTCM debacle, but instead "a way thinking about a of investing v

been involved in for a number of that we find quite interesting."

Hedge funds like his with portfolios that are neither long nor short, but market neutral, he said, are attracting interest because of the tech-stock "I've seen an explosion in demand for this product," Meriwether told the beleaguered audience. "This asset class, at least historically, has performed



"The industry would be better off if he kept a low profile"



WHAT HOLDS JOHN MERIWETHER BACK

The legendary bond trader and founder of Long-Term Capital Management is back in business as JWM Partners. But he is finding it hard to raise money

LOST LAUREATES

His Nobel prize-winning partners Myron Scholes and Robert Merton are gone, hurting marketing to investors

CREDIBILITY GAP

Potential investors still worry that the new firm will not disclose all the risks involved in its trading

TARNISHED NAME

The stigma from the near-collapse of LTCM persists, deterring many potential investors

COPYCATS

Competitors now know how to duplicate his trading strategies, limiting profit potential

LESS LEVERAGE

With investors and lenders wary of the risks, JWM is limiting its leverage to about 12 times its capital and crimping its profits possibilities

Data: BusinessWeek

whether that is Meriwether's choice or the most JWM investors and lenders will allow.

Using less leverage might reassure investors who fear another bust, but it means JWM is unlikely ever to achieve the 40%-plus annual returns that LTCM once racked up. Besides, a rash of copycats, who now imitate the same trading tactics he used at LTCM and at Salomon Brothers before that, will crimp his profit potential. So sophisticated investors understand that they're unlikely to earn the superprofits they did during Meriwether's glory days. "It is a hard sell," says Michael Ocrant, editor-in-chief at fund tracker MAR, a division of Metal Bulletin PLC. Barry H. Colvin, chief operating officer of Tremont Advisors Inc., says: "It is not just Mr. Meriwether, many other fixed-income money managers are having a difficult time gathering new assets."

"STAR STRATEGY." When raising money for LTCM, Meriwether had the marketing advantage of a trio of celebrity partners behind him—David Mullins, a former Fed vice-chairman, and Myron Scholes and Robert Merton, both winners of the Nobel prize for economics. None of the three is with him now, leaving him alone to battle the suspicion that LTCM's risk-taking blindsided past investors. Jane

Buchan, a managing director at fund-of-funds firm Pacific Alternative Asset Management Co., says she invests in other hedge funds doing Meriwether's type of trades but not with JWM. Why? Because she doubts Meriwether will ever want to show her exactly what he's doing.

In his charity speech, Meriwether said hedge funds need "an emphasis on star strategy vs. star management." Fund managers, he said, have "become much more transparent in our approach because we recognize that investors need to know not only the style of investing, but the riskiness." He's saying the right things, but still not making enough converts among the investors who once flocked to him.

By David Henry in New York

As proof, he cited a February, study by two professors at the Sloan Business School.

One of them, Narayan Y. Naik, told *BusinessWeek*: "That is going a bit much." The study was a "starting point" in analyzing fund performance. It only averages of results funds fed to a tracking service for January 1994, through September, 1998, too a period to be called "historical," he noted, scholars doubt that fund results are as steady, or month-to-month as the funds tell us. That's because their returns are often simply estimated as of their holdings aren't priced daily in the markets. "I wouldn't have expected him to use this paper," said Naik.

Meriwether described his own product as "a form of relative value investing." The firm looks for pairs of securities, such as a newly issued 10-year Treasury and one issued months before, that have the same underlying risks and cash flows but are trading at different prices for some transient reason.

Part of Meriwether's legend is that he was one of the first to arbitrage bonds by selling one and buying the other in anticipation of their prices converging. Because the differences in price, or spreads, are so small, he must use lots of borrowed money—or leverage—to make his trades worthwhile. LTCM used leverage of \$30 of loans to each \$1 of its own capital. JWM uses a ratio of only about 12 to 1, though it is unclear

Hedge-fund pro says of Meriwether's comeback attempt



INVESTING

MEDIA STOCKS: WHY THERE'S SUCH BUZZ

They plummeted alongside tech. But that's old news

Betting on media stocks last year was about as smart as putting money on CBS News to call the Presidency right on election night. They got roughed up almost as badly as tech stocks. But while techs have yet to stage a comeback, many media stocks are now basking in the spotlight (table). So far this year, despite a much slower advertising market, the Bloomberg U.S. Media Index is up 13%, compared with a 15.6% drop in the Nasdaq Composite Index and the 5.4% decline in the Standard & Poor's 500-stock index.

What's the deal? Media analysts contend that the stocks were way oversold after the Nasdaq crash, largely because of the collapse in dot-com advertising, as well as investors' misperception that the fate of media companies was the same one facing telecoms and Internet companies. "Media was the baby that was thrown out with the bathwater," says Christopher Dixon, media analyst at UBS/Paine-Webber. But now, he says, investors are realizing that many media companies have solid

fundamentals, attractive valuations, and the most benign regulatory environment in years.

These days, many media companies are affected much less by advertising slowdowns. Indeed, two distinct classes have emerged: large, diversified outfits, such as AOL Time Warner Inc. and Viacom Inc., that depend less on advertising revenues, and pure-play media companies, such as newspaper giant Gannett Co. and radio powerhouse Clear Channel Communications, that are much more exposed. It's mainly the diversified companies that analysts find attractive now. "These companies have stable operating results and big consumer demand," says Dixon.

A prime example is AOL Time Warner, which has Internet, broadcast cable, and print operations. Because many of its services are subscription-based, advertising accounts for around 25% of revenues. Jessica Cohen, media analyst at Merrill Lynch & Co., is high on the stock for the year, "because the merger is all set to come together." Cohen's favorite stock right now, however, is Viacom, which she says has a tremendous subscriber base, great brands, great management and an impressive balance sheet, trading around \$56, or 30% off its 52-week high. Viacom operates MTV, Nickelodeon; it owns CBS and UPN and operates 184 radio stations. It also owns Paramount Pictures and is a publisher. Viacom's exposure to advertising is about 45% of sales. Once the market turns, analysts say, the stock could gain 20% or more. Viacom trades at 13 times next year's projected earnings, vs. a typical 16 times for media conglomerates.

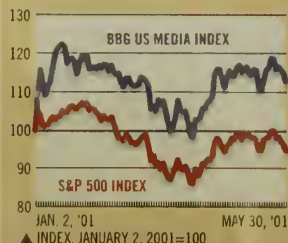
MULTIFACETED. Liberty Media Group, which has video, communications, and Internet businesses, is another diversified play. Soon to be spun off by Time Warner, many contend it will be a global powerhouse as it makes inroads into Europe and Latin America. And the stock, owned by The McGraw-Hill Cos., *BusinessWeek* parent, has been faring well. Under the new ownership, 70% of its revenues come from advertising.

Pure-play media companies could rebound next year if the economy picks up. "Advertising-based media stocks lead out of a recession, so you would already be in these stocks as this year begins," says Scott Mayo, co-portfolio manager at John Hancock Large-Cap Value and Small-Cap Value Funds. In fact, Clear Channel stock took a hit at the beginning of the year because investors had already priced in a prolonged ad environment six to 12 months down the road, says Mayo.

Of course, there are naysayers. Wolstein, media analyst at Sanford Bernstein & Co., says he doesn't see advertising spending making a rapid comeback. "We may be having a disconnect between reality and the revenue side of the earnings side and the performance of these stocks," he says. But even he concedes that diversified media companies with less advertising exposure are worth considering in this environment.

By Marcia V...

A CUT ABOVE THE S&P



Best-performing media stocks, year-to-date

COMPANY	RETURN (TO 5/30/01)
AOL TIME WARNER (AOL)	46.8%
FOX ENTERTAINMENT (FOX)	44.7
USA NETWORKS (USA1)	27.6
CLEAR CHANNEL (CCU)	25.9
AT&T-LIBERTY MEDIA (LMG/A)	23.5
VIACOM (VIA)	19.1

Data: Bloomberg Financial Markets

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MOVING at the SPEED of BUSINESS

COMMENTARY

By Christopher Palmeri

POLITICIANS SHOULD BUTT OUT OF PENSION FUNDS

Nothing better illustrates the folly of letting politicians loose on investment decisions than what has been happening in California. In late 1999, ambitious State Treasurer Philip Angelides seized upon socially responsible investing as a way to make his mark. He argued that as well as undermining the public health, tobacco companies face legal and regulatory challenges that could bankrupt them. Angelides helped persuade the boards of California's two largest pension funds to sell their \$800 million in tobacco shares.

Since Angelides began his crusade, the American Stock Exchange Tobacco Index has more than doubled—and Philip Morris Cos. was the best-performing Dow Jones industrial average stock in 2000. The reasons? The companies boosted revenues by raising cigarette prices, and Wall Street cheered restructuring moves such as R.J. Reynolds' sale last year of its Nabisco operations and the upcoming initial public offering of Philip Morris' Kraft Foods Inc. unit (page 160). There was also a perception in the market that the worst was over for tobacco companies, in part because of a \$246 billion master settlement with all 50 states.

BusinessWeek estimates that two California state pension funds could be as much as \$447 million out of pocket due to the lost appreciation of their tobacco shares. That assumes the the California State Teachers' Retirement System (CalSTRS) netted the average price of the stocks during the five months it took to unload them. The same method was used for the California Public Employees' Retirement System (CalPERS), which is still in the process of divestiture. Those estimates don't even count transaction costs and the likely poorer returns from reinvestment of the tobacco proceeds in the overall market. A spokesperson for CalPERS disputed the estimate, while the teachers' pension system declined comment. Neither would disclose the actual numbers.

All the same, Angelides is undeterred. "These investments don't make sense from an investment standpoint or given the ill effects the products are having on society," he says. "Continuing pressures on the industry make tobacco investments risky over the long term." Indeed, tobacco companies do still face a host of legal challenges including a Justice Dept. suit and a large private judgment in Florida now on appeal.

STAINED FINGERS. Nor is California alone in what it's done. In all, nine states have divested or limited the tobacco investments of their pension funds, selling off more than \$3 billion worth of shares in the process. And some other local pols have been as vehement in their advocacy of divestiture as Angelides. "It's hypocrisy for the state to be holding \$400 million worth of tobacco stocks while we are suing the tobacco companies," State Treasurer Barbara Hafer said during Pennsylvania's divestiture debate in 1997.

That's not the only hypocrisy involved. States have long had huge finan-

cial interests in tobacco, stretching well beyond the returns on their pension funds. They collect some \$12 billion in cigarette taxes each year. And the \$246 billion master settlement has given them an even greater stake in Big Tobacco's viability. In the last year, five state legislatures have, at the prodding of tobacco companies, passed laws that limit the sums businesses have to post as bonds when they lose product liability cases.

Indeed, political winds shift almost as quickly as the stock market. For example, Florida initiated the largest state tobacco divesti-

ture, \$835 million in 1997, under then-Governor Lawton Chiles, a Democrat. Now, with Republican Governor Jeb Bush, Florida is considering reinvesting in tobacco shares. Maryland and Kentucky, which began divesting in 1996, already have. "To ignore politics is to ignore the 800-pound gorilla in the room," says Douglas G. Cogan, director of tobacco research at the Investor Responsibility Research Center, a nonpartisan group that advises large pension funds.

That may be, but state pension funds are being steered into treacherous waters when political grandstanding forces them to mix controversial social goals with their clear financial mandate. As the ill-timed divestiture in California shows, politicians should set only the broadest investment guidelines for state funds and leave the stock-picking to the pros.

Palmeri covers finance from Los Angeles

Up In Smoke?
Several state pension funds have dumped tobacco stocks

CALIFORNIA Divested \$800 million in 2000. Subsequent runoff could cost \$447 million.

FLORIDA Divested \$835 million in 1997. May reinvest with support from Governor Jeb Bush.

KENTUCKY Partial sale of tobacco stocks began in 1996. Policy rescinded in late 1998.

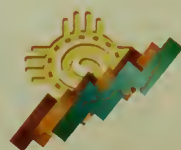
MARYLAND First state to sell all its tobacco holdings in April, 1996. Bought back again in 1999.

Data: State Treasurers, BusinessWeek

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COMMENTARY

By Gerry Khermouch

AN ALMOST-INVISIBLE \$1 TRILLION MARKET

should have been the start of a marketing bonanza. The recently released Census 2000 numbers revealed an explosive population increase among blacks, Hispanics, and Asians, with those groups now accounting for 79 million out of 281 million Americans. Collectively, they represent an estimated \$1 trillion in annual spending power. So companies soon be flooding the markets with targeted products, services, and advertisements designed to woo those consumers, right?

Don't hold your breath. A host of barriers will block any stampede into multicultural marketing. First, there's the appalling lack of data on buying habits among minorities, making it difficult for marketers to make good decisions. Then there's the economic slowdown. Any marketing effort deemed discretionary is in danger of outright cancellation these days. But the biggest obstacle originates from inside the executive suites, where many decision makers are hobbled by a range of tenaciously held misconceptions about minorities' buying power and brand loyalty.

COMFORT ZONE. Some companies, of course, have gotten it right. Sears, Roebuck & Co.'s most profitable stores are the ones near Hispanic neighborhoods that carry clothing and cosmetics specially designed for Hispanics. Bank of America has prospered by targeting Asians in San Francisco with separate TV campaigns aimed at Chinese, Korean, and Vietnamese.

But for many marketers, such efforts would require them to move outside their comfort zone dealing with white, English-speaking Americans. Many simply haven't caught on—these fast-growing groups have similar aspirations to other Americans—and the money to achieve those goals. With minorities underrepresented in upper-management ranks, attitudes are difficult to change. They need to realize even terms like 'minority' don't quite fit the reality

any more," says Eliot Kang, CEO of Asian-marketing agency Kang & Lee. It's no accident that some of the most aggressive ethnic marketers, like Sears and Verizon Communications, have had minority executives among their top brass.

Even for the motivated, there are practical hindrances. Spending decisions hinge on marketing data that simply don't exist for many ethnic groups. Mott's Inc. has managed to build a following among Hispanics for its Mott's Juice, Hawaiian Punch, and Clamato brands—but says it has had few numbers to guide it. Supermarket-scanner data on Hispanic purchasing

behavior is reliable only in Los Angeles and San Antonio because in most cities the samples underrepresent outlets in Hispanic neighborhoods. Meanwhile, household-survey data that should offer a more detailed profile of these consumers are rare, says Lesya Juchymenko, vice-president of marketing for Mott's.

The gatherers of broader data haven't proven any more adept at counting minority groups. Nielsen Media Research Inc. and Arbitron Inc. have struggled to get a handle on Hispanic TV and radio households,

while many non-English print publications are not even tracked.

That means that companies determined to reach ethnic markets are forced to improvise.

Mott's, for instance, ferrets

out hidden pockets of demand by studying the U.S. touring schedules of Latin American bands such as Banda El Recodo and Los Tucanes and beefing up its marketing in those areas.

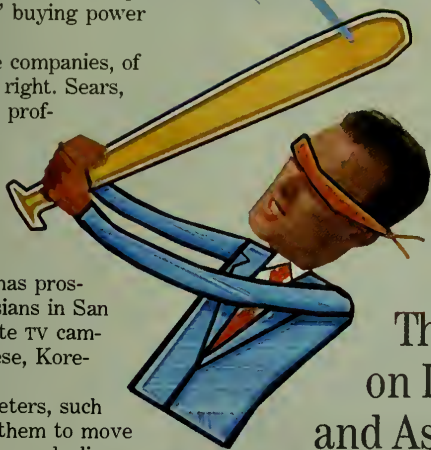
Procter & Gamble has gone so far as to establish a unit in Puerto Rico to direct the Cincinnati company's Latino-marketing efforts.

Progress is at hand on some of these issues. Data from the census long form, due later this year, will offer a more detailed glimpse of ethnic Americans, including language-usage patterns. And Nielsen has already promised to redo its national-TV home sample to better reflect the increased Hispanic presence.

That will help, but the truth is most companies still treat ethnic marketing as an optional effort, a little something extra to pursue when times are good. That's a shortsighted view. Marketers need to wake up to the fact that there are now 79 million reasons why ethnic-marketing programs are no longer simply "discretionary."

With Aixa M. Pascual in Atlanta

The data on Latino and Asian American spending patterns are appallingly inadequate



Shopping for a New TV? Bring Aspirin

The long shift to digital has made the choice more complex

BY LARRY ARMSTRONG

I went TV shopping recently, and it's not a pretty picture. Television is moving from analog to digital, just like everything else in your living room. But while the transition to digital high-definition TV (HDTV) promises stunning pictures on your own silver screen, things are getting infinitely more complicated. That's because we're going through the first real change in the way television pictures look and are transmitted since color TV came along in the 1950s. Broadcasters are reluctant to spend the money for all-new cameras and transmission gear. And Napster-stung studios are stalling, worried that picture-perfect digital copies of their reality shows and sitcom hits will leak out onto the Internet.

The result: No matter what you do, you'll be caught in the middle of a long, drawn-out shift from analog to digital that will make television shopping more of a chore than it ever was. It used to be that you just had to decide what was the biggest size set that would fit your space and budget. Now, you must ask yourself: Should I go digital now to future-proof the set against the day when analog broadcasts are switched off for good? Should I pay extra for a wide-screen—a Cinema-like set that fits today's DVD movies and tomorrow's HDTV broadcasts—or stick to the traditional, squarish TV that best fits the gaping hole in the middle of my entertainment center?

The good news is that whatever TV you buy today will not become obsolete. When broadcasters switch over to all-digital transmissions, now slated for 2006, at most you'll have to buy a black box for about \$100 that converts the new signals to the analog form required by your TV.

Budget and screen size are still the best places to start. You can get great-looking conventional sets as big as 36 inches starting at about \$1,000 and 32-inch sets for \$600 to \$800. *Consumer Reports* recommends models from Toshiba and Hitachi, among others.

If you want the best picture money can buy, however, you should be shopping for a digital TV. Prices have come down dramatically over the past year, to the point where big-screen digital sets can now

be had for less than \$2,000. But you'll have to contend with a variable you've never had face before: What shape should the TV be?

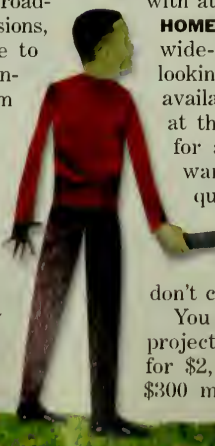
The beauty of a wide-screen TV—with viewing area that's nearly twice as wide as it is high—is that it can accommodate the new rectangular-shaped HDTV broadcasts without black bars on the top and bottom or fill out the screen. And it's a better match for wide-screen movies, either broadcast on TV or from your DVD player. The problem is that most of what's available to watch on TV today is still transmitted in the squarish format and would appear in the middle of a wider screen with ugly gray bars filling out the sides.

Still, my recommendation is to go with a wide-screen set if you can afford it, especially if you use your TV mostly for watching such fare as movies. Besides, setmakers have up with several ways to get around the waste of space on your expensive

They stretch the picture to fit, with most stretch (and distortion) on the right and left edges. Or they zoom in, pushing the gray bars as well as the top and bottom of the picture to the edges of the screen. Some wide-screen projection models, including all wide-screen projection models from Mitsubishi and Pioneer, have as many as four different ways of making the old square-picture better fill the screen. Make the show you them all, and make sure you can live with at least one of them.

HOME THEATER. The decision to go with a wide-screen TV isn't as tough if you're looking for a projection TV, the only type available above 40 inches. For one thing, at that size, you're really in the ballpark for a home theater, and you probably want a TV that mimics the look and quality of a movie screen. For a wide-screen projection TV, it's much more difficult to make the picture than the squarer one, and it doesn't cost much more.

You can get a 46-inch wide-screen projection monitor from Mitsubishi for \$2,100, for example, just \$300 more than a





50-inch analog projection TV in the traditional screen format. If you want a glass-tube TV, though, be prepared to pay close to \$1,000 extra for HDTV, plus another \$1,000 or more for the wide-screen version. A 36-inch HDTV monitor from Toshiba goes for \$1,895, vs. \$900 for an analog TV; a comparable 34-inch wide-screen HDTV monitor from Toshiba costs \$2,670.

One good strategy is to buy an HDTV monitor, also called an HDTV-ready or HDTV-upgradeable set, instead of what's now being called an "integrated" HDTV set, with the HDTV tuner built in. Even the monitors have a conventional tuner to display analog-TV signals or play DVD movies, and you can add the HDTV tuner when HDTV

broadcasts become more common. Tuners now cost \$600 to \$1,000, depending on whether they can receive satellite-TV signals, over-the-air HDTV transmissions from a rooftop antenna, or both. Another reason to wait: With a handful of exceptions, cable-TV companies haven't decided how they will handle HDTV signals.

GHOSTS AND SNOW. Beware of the non-high-definition versions of digital TV sets that some TV makers, including Sony, offer. They're called enhanced-definition and standard-definition TVs. These EDTV and SDTV sets look better than analog TV, but that's because of the cleaner digital signal, which gets rid of ghosts and snow. They also, like all of the new digital sets, have picture-enhancement circuitry to smooth out the TV picture from analog broadcasts. (You can compare the improvement on different brands by looking for zigzags along diagonal lines in the picture.) But only HDTV sets can display the higher resolution that HDTV signals provide. Other digital sets must downgrade the HDTV signal before they can display it.

Since I'm not a diehard movie fanatic, in the end I decided to hold off on buying a new set until more digital programming becomes available. But some weekend nights, after I pop a DVD into the player and a bag of popcorn into the microwave, I have second thoughts. It must be the smell of the popcorn. □

Great-looking 36-inch conventional sets start at around \$1,000. But for the best picture, you'll have to go digital, which will cost twice that

Picture Perfect

- ▶ Figure out what you watch most. If it's wide-screen movies, the price premium for a wide-screen set may be worth it, especially if you're buying a projection TV.
- ▶ Buy an HDTV monitor, not an HDTV set. You'll still be able to get today's conventional TV broadcasts, and you can add an HDTV set-top receiver when more HDTV programming is available.
- ▶ Make sure you bring home a high-definition TV (HDTV). Don't settle for lower-resolution standard-definition (SDTV) or enhanced-definition (EDTV) versions.
- ▶ Make sure there are plenty of connection options on the back of the set. You'll need that flexibility when you start hooking the set up to DVD players, antennas, cable boxes, and your audio system.



My Life: The Director's Cut

Making snazzy home videos is a breeze

BY ROY
FURCHGOTT

I tried out four popular mini DV cameras, ranging in price from \$799 for the Canon ZR20 to \$1,799 for Sony's DCR-PC110

We were in the French Alps, relaxing after a dinner with fine wine, unaware of the horror about to befall us. Then it happened. My girlfriend's uncle announced: "I've got a video of our trip to Las Vegas." Okay, so we weren't hit by an avalanche. But while watching seemingly endless footage of casino after casino after casino, I wished we had been.

To be fair, it wasn't the worst video I'd seen. Not even close. But today, you have no excuse for making boring home movies. The current crop of digital camcorders and simple-to-use editing software makes it possible for just about anyone, with a little practice, to produce a short, entertaining flick.

To see just how difficult it is to make a decent home movie, I attempted the task myself. First, I had to pick a camera. I wanted digital because the footage is easy to download to a computer for editing. I chose the compact Mini DV format with its small cassettes. The bulkier Digital8 op-

tion is a good choice for people who have a collection of old analog 8mm and Hi8 video that they want to play on the same machine.

Next, I considered the CCD, or charged-coupled device—the chip that turns light into data. The highest-quality video cameras use CCDs to capture the truest color, but those eras were bigger and more expensive. I decided to settle for a single-chip camera, keeping in mind that chips come in different sizes and pixel counts. Generally, the bigger the chip—as in the $\frac{1}{2}$ -inch CCDs that professional quality cameras use—have more pixels, which are the little dots that make up a picture. I wanted to avoid cameras that use software to interpolate the pixels because these "interpolated" images can suffer in quality.

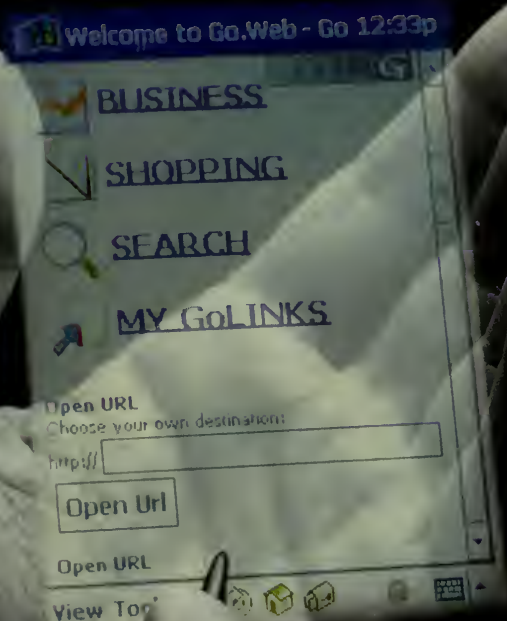
I tried out four popular mini DV cameras with a single $\frac{1}{2}$ -inch CCD, ranging from 290,000 to 690,000 pixels depending on the model. All had the IEEE 1394 port, which allows for high-speed downloads. They all use long-lasting lithium-ion batteries. A single charge lasts for 40 to 70 minutes, so you'd want to pack a spare battery, which may cost up to \$150. The lowest list price was for the \$799 Canon ZR20, followed by the \$1,299 Canon ZR30, the \$1,399 JVC GR-DVM90, and the \$1,799, the Sony DCR-PC110.

The JVC was the smallest and lightest, and it was packed with features, including video effects that allow you to create a sepia tone or create such transitions as fades and dissolves. It didn't have the in-camera editing option of the Sony and the Canon ZR30, but that didn't bother me. Why edit a camera when it's so much easier on the computer?

While the lower-priced Canon ZR20 was the equal of the others in bright sunlight, it



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Once I had conquered basic editing, assembling the video was fairly easy; however, I still had a lot to learn about basic filmmaking



shoot well in lamp-lit rooms, although its tiny clip-on movie light helped. The Sony has a special low-light feature and a built-in auxiliary light.

Compact cameras are so light that your breathing alone is enough to make the handheld shots quake. The Canon Optura Pi has optical image stabilization, which means the lenses actually move to keep the image centered. The other cameras use electronic stabilization, which uses software to quell wobbles but can hurt image quality.

"RUN & GUN." I made my test film at a group bike ride. Looking at my footage, I found that the image stabilizers worked well, but sometimes not well enough. I should have carried a tripod, or better yet, as salesman Robert LePow from B&H Photo in New York suggested, a more portable monopod that lets you "run and gun."

When it came to picking editing software, I went with iMovie, which was already installed on my Macintosh laptop. The iMovie program—which is similar to programs for the PC, such as Media 100's IntroV (\$69), Adamation's Personal Studio 2.0 (\$59), and Ulead's VideoStudio 5.0 (\$99)—lets you edit the length of your clips, put them in the desired order, adjust color and exposure, and add special effects. It also lets you add titles and transitions between scenes, as well as voice, music, and sound-effects tracks. More powerful programs, such as Final Cut Pro for Macintosh and Adobe's Premiere for the PC, cost about \$600 and are frustratingly difficult for a beginner.

Dell Computer spokesman Rob

Kaufman says a PC user would want a machine with a minimum 128 megs of RAM, a 20-gigabyte hard drive, 32-megabyte videocard, and an IEEE 1394 card. A Dell computer preconfigured for editing costs \$1,358, including editing software. I used Videowave from MGI Software. My little iBook, with a 366-megahertz processor and 128 megs of RAM, was up to the editing task. A digital video ate up a huge amount of my hard drive—one gigabyte for five minutes of video. A compressed MPEG2 file gave me about 10 minutes per gigabyte, but compression may vary with the picture quality.

NO SCENERY. As it was, I had problems with the simple iMovie. First, it has no instruction manual, only a computer tutorial. When it came to the "scrubber bar," I was at a complete loss. Following the directions exactly, I was able to trim a video clip. It took a call to Apple for an answer that isn't offered in the manual (and heaven help anyone calling tech assistance). Additional help is available at Atomic Learning (www.atomiclearning.com/freeimovie.shtml), where you can buy an instruction guide, such as *iMovie 2: The Missing Manual* by David Pogue (Pogue & Associates, \$19.95).

Once I had conquered basic editing,

assembling the video was fairly easy. Sadly, I found that I still needed to conquer basic filmmaking: I was shooting on a 100-person, 10-mile bike ride near Annapolis, MD. My biggest problem was I had too many clips of people riding, all from the same angle. I had to edit in enough frames of scenery to show the reactions of people as they rode by. Next time, I'll know to write a story outline and a "shot list" of clips I'll need. I also learned that it doesn't pay to tape over old footage. The eraser heads in the newer digital cameras sometimes leave traces of old data, which can then show through, leaving a pixilated or double-exposed image of the old image on top of the new one. One solution is to use a bulk eraser and \$15 high-tapes, but it may be just as expensive to buy \$7 tapes to use only once. Not all was lost. I assembled a most interesting images into a series of one-to-four-second clips, added lively music, and voila!—a music video! By keeping the pace a fast-paced minute or two, I got away from complaints of boredom. I won't be satisfied until someone asks: "Can we see it again?"

Watch extended coverage of BusinessWeek's home entertainment package June 3 on Money, which airs Sundays on ABC and affiliated stations. Check your local listings.

Ten Shots to a Home Movie

If you lack the right images, you can't fake it even with fancy editing tricks. So think ahead, and plan a "shot list." Short shots—four seconds at most—work best. Here are 10 possible shots for a 30-second movie.

- 1 Title: *Baby's First Steps*
- 2 Establishing shot of Mom holding Baby
- 3 Close-up of Mom's hand on wobbly Baby
- 4 Close-up of Baby's face
- 5 Close-up of Mom's face
- 6 Close-up of Mom's hand letting go of Baby
- 7 Close-up of Baby's foot as he takes a step
- 8 Close-up reaction shot of Mom's face
- 9 Medium shot of Baby toddling toward the camera
- 10 Title: The End



An Insurance Hunter's Weapon of Choice: The Web

The do's and don'ts of finding an affordable policy online

BY ANNE TERGESEN

Buying insurance has never been a very consumer-friendly experience. Until recently, scouting out the best deal meant spending hours on the phone with various salespeople to compare policies. Even then, you could never hope to sample more than a fraction of the insurers licensed by your state.

Now, thanks to Web sites that gather quotes from a number of insurers, there's a better way. "In pre-Internet days, if you wanted to compare a couple hundred policies, you had to call a couple hundred agents and brokers, whereas now, you can do it in a couple minutes," says Austan Goolsbee, an associate professor of economics at the University of Chicago Graduate School of Business.

To be sure, even the most comprehensive Web sites won't come close to giving you quotes from all the companies out there. And some types of insurance, such as whole life, are so complicated that getting an accurate quote almost always re-

quires a conversation, if not a medical exam. Moreover, since most sites still seal deals with phone calls instead of mouse clicks, only about 1% of policies underwritten in the U.S. are sold online. But if you surf sites that do a good job with auto, homeowners', term life, and other forms of insurance that translate well onto the Web, you'll get a sense for what is and isn't a good deal.

The Web has already had a powerful impact on prices. Between 1995 and 1997, term life rates fell by as much as 15% as the availability of online comparisons forced insurers to get more competitive, according to a study by professors Jeffrey Brown of Harvard University and Goolsbee.

Some carriers are cutting rates even deeper by designing policies just for the Web. Take John Hancock's MarketPlace, which like other term life products provides coverage for a fixed number of years. Although your exact savings depend on variables including your risk profile, MarketPlace is generally 10% to 20% cheaper than similar policies sold through Hancock

Insurance



No single site can show you the entire market, so visit more than one. And when you've got a bargain, see what kind of service you can expect

agents, says Diana Scott, vice-president of e-business for John Hancock Financial Services. Still, before you opt for an online policy's savings, make sure you can live with its features, which tend to be more basic than their offline counterparts'. MarketPlace, for example, offers fewer options for converting to other types of life insurance.

To start a search, go to a site with access to quotes from more than one company. Be prepared to spend up to 15 minutes answering questions about your driving record, medical history, or other topics related to the coverage you seek. Then, wait a few minutes for quotes for comparable policies.

Which specific site makes the most sense depends on the type of insurance you are buying. If you are in the market for auto insurance, InsWeb wins the highest marks from Gómez, a Waltham (Mass.)-based consultancy which rates online financial services. For life policies, Fidelity Investments' Insurance.com tops the Gómez scorecard, which weighs factors including ease of use and comprehensiveness of products and services.

Each site partners with different companies. So don't assume that any one site is giving you a full view of the market. For this reason, even if you think you've uncovered the best deal, check other highly rated sites before buying (table).

Sites that ask more questions—such as InsWeb—deliver quotes that most closely resemble the premiums you will pay, says Todd Eyler, senior analyst at Forrester Research in Cambridge, Mass. It's not always easy to answer questions such as how much bodily injury liability coverage or inflation protection you need. Most sites provide definitions—and a phone number to call for help. Several sites, including Quicken.com and In-

surance.com, have calculators that help you compute approximate levels of coverage.

While most sites deliver quotes right away, don't be surprised if you encounter delays. A recent test by InsWeb, for example, yielded instant quotes on a policy for a Ford Escort. But had I purchased right away, I would have missed out on a lower quote, which arrived e-mail a day later.

The site for your state insurance department should be your first stop for a list of carriers licensed to sell the product you are buying. (You can find a link at www.aorg.org.) If you spot carriers you search overlooked, you can contact them up online or by phone.

STATE RANKINGS. Many state insurance sites also publish comparison tables. They can give you an idea of who offers the best and lowest quotes to typical customers with certain characteristics. While these tables don't tell you what you can expect

to pay for your policy, they might help you compare companies with low prices, says Amy Danaher, director of Insure.com, a site that publishes insurance-related news.

Finally, many state sites provide records on insurers. Don't skip this step; a bottom quote can mean rock-bottom service. Insure.com and most multiquote sites also publish financial ratings from services such as A.M. Best. Look for carriers rated A or better.

You generally can't purchase a policy directly from a multiquote site. At Quotesmith.com, for instance, you can buy directly from only 5 of the 30 companies that supply quotes, says Chairman and CEO Robert Bland. Instead, many sites require you to fill out an application and e-mail it to a carrier. Then an agent calls with a final quote. A policy can be issued anywhere from minutes to several days later, says Forrester's Eyler.

A growing number of insurers, such as John Hancock, are letting consumers buy from Web sites as well as get quotes. So far, most online purchases have been auto-related. As a result, 9 of the 20 largest auto carriers, including Progressive and Allstate—sell online in at least one state, according to

Say you log on and find an attractive quote for your new car. You can download and print out a policy, fill out an application, punch in your credit-card number, print out a temporary insurance card, and drive away. The carrier will issue permanent coverage once it has verified the information you submitted. (If it uncovers information you have not disclosed, your rate may rise. In extreme cases—coverage may be voided.)

Using the Web to shop for insurance has limitations. But by making it much easier to compare prices, it should help you save money.

Sizing Up Insurance Sites

GÓMEZ RANKING*/ SITE (WWW.)

COMMENT

1	INSWEB.COM	Large number of automobile quotes
2	ANSWERFINANCIAL.COM	Strong in educational content
3	INSURANCE.COM	Has everything from auto to pet insurance
4	PIVOT.COM	Must fill out auto application over the phone
5	YOUDECIDE.COM	Helpful tools such as calculators
6	QUICKQUOTE.COM	Strong in life insurance
7	RELIABLEQUOTE.COM	Quick and easy quote form for rate estimates
8	QUOTESMITH.COM	Wide selection of term life quotes

* Overall Ranking, December, 2000.

Data: Gómez Inc.; BusinessWeek



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KRAFT'S IPO: NOT TOO CHEESY



BY ROBERT BARKER

rb@businessweek.com

Kraft has only one rival—Nestlé—for the title of global food and beverage king. In a comparison of the two, Kraft comes off smelling better than hot chocolate

Loretta Nedved, a retired nurse and small investor in the Sacramento Valley town of Elk Grove, Calif., has been waiting for months. Back on Wall Street, big-money pros such as Robert Doll, global chief investment officer of Merrill Lynch's funds group, are feeling just as expectant. What's uniting these two and legions of other investors? Anticipation of the mid-June initial public offering of stock in America's No. 1 food-maker, Kraft Foods.

You can thank (or blame) Kraft for such stuff as Tang, Jell-O, Oreos, Cheez Whiz, and Oscar Mayer Lunchables. Its stock is going public courtesy of Philip Morris, which you can thank (no, blame) for Miller Lite and Marlboro. Philip Morris assembled the food giant over 15 years via mergers with General Foods, Kraft and, late last year, Nabisco. Now, it is selling 16% of Kraft for about \$8 billion.

This mega-IPO, Nedved told me, is a chance to buy into a company "that has been around for a while and has good things behind it"—unlike so many of last year's tech IPOs. Doll, whose funds own Philip Morris stock, said the deal "will do nothing but accentuate the value" of the food assets that are locked inside the tobacco company. Yet for many investors everywhere, the question remains: Is Kraft coming to market at a price that's any more tempting than a plate of Velveeta?

At first glance, I would have said no, and not just because most IPOs wind up losers. Kraft's indicated share price, \$28.50, works out to a market value of nearly \$50 billion, or 35 times what the company would have netted in 2000 had it owned Nabisco for the full year. Yet after looking at its financials and those of its leading rivals, I think Kraft holds some hidden attractions.

In scope and scale, Kraft has just one, maybe two, rivals. With sales of \$35 billion in 140 countries last year, it dwarfs all the familiar U.S. food



GOODIES:

Margins are fat

names. H.J. He distant runner-up \$9.3 billion, wh rope's Unileve ting its \$44

business evenly between cleaning products, probably as a peer. But it is Switzerland's Nestlé, the world's food company, that Kraft best to reach its goal explicit in the prospect of being "recognized the undisputed leader the global food and age industry."

CRUNCHING NUMBERS.

S does Kraft compare with

Last year, Nestlé's sales grew \$50 billion. Sales at Kraft, assumed to have owned Nabisco since the 1999, rose just 1%. But from 1999, Kraft begins to look better. In 2000 earnings grew 22%, to \$3.5. With Nabisco, Kraft would have 26% growth in net profit, to \$1.4. More striking is Kraft's super efficiency. Its operating profit margin, 13.2%, came in two percentage points fatter than Nestlé's. Looked at this way: Nestlé's 225,000 employees generated an average of \$25,000 in operating profit, while each of Kraft's employees made \$39,000 (table).

Kraft brings less of its operating profit to the bottom line than Nestlé, because past acquisitions have an expensive legacy of interest on goodwill amortization. The first burden will lighten after the IPO, as Kraft uses

proceeds to repay half the \$15 billion it borrowed from parent Philip Morris to buy Nabisco. Its debt cut that much, Kraft last year have saved \$601 million. And if a proposed accounting rule change is adopted, Kraft longer have to amortize goodwill regularly next year on. Quarterly charges for goodwill, including Nabisco, would have cost Kraft \$1 billion in 2000. Those savings together with more than Kraft-Nabisco earned last year.

Don't get me wrong here. I'm not saying Kraft is the cheapest stock on the block. It is sell for 13 times last year's cash flow times sales. But Nestlé goes for 16 times cash flow, 1.8 times sales. True, Nestlé is independent and Philip Morris will still control Kraft. But you're shopping for a global food giant that looks like the bargain brand.



Comparison Shopping

COMPANY / SYMBOL*	REVENUES (\$MILLIONS)	OP. INC. (\$MILLIONS)	MARKET VALUE (\$MILLIONS)	MARKET VALUE / REVENUES	OP. INC. / EMPLOYEES
KRAFT FOODS KFT**	\$34,679	\$4,562	\$49,448	1.4	\$38,991
NESTLÉ NSRGY	49,648	5,601	87,441	1.8	24,949

*All financial results for year ended Dec. 31, 2000; market values as of May 23

**Pro forma showing full-year consolidated results for Kraft and Nabisco;

market values are tentative; market value assumes \$28.50 IPO price

Data: Company reports, BusinessWeek

BusinessWeek online

For barker.online, go to www.businessweek.com/investor/ and click on "Investor"

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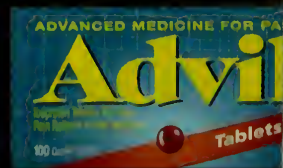
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JACKPOT FOR IGT?



G. MARCIAL

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When International Game Technology (IGT) was trading in the mid-20s a year ago, several would-be suitors tried to entice the world's largest maker of computerized gambling systems into a buyout. But Chairman and CEO Chuck Mathewson was convinced that IGT, which makes such devices as slot machines and video poker games, was worth at least twice the going price. So he ducked the feelers.

The stock has rocketed to 60, giving IGT a market cap of \$4.4 billion. With the stock up, Mathewson hasn't put up a For Sale sign, but he's more amenable to a takeover, say insiders. Has he had any nibbles? Mathewson, who turns 73 in June, said: "We've become too big for the people who were interested when the stock was in the 20s." But insiders say IBM and Microsoft have expressed interest. With its new Xbox video-game platform, Microsoft could develop markets via IGT's gaming systems. And IBM could enhance IGT's high-tech, high-cash-flow operations worldwide. As IGT diversifies into other entertainment fields, such as its new video games based on *The Price Is Right* and *Austin Powers*, IBM and Microsoft will get drawn to IGT, says an IGT exec. "Either would be acceptable to Chuck," he adds. Microsoft declined comment. IBM didn't return calls.

One new IGT product: a "cashless" gaming system. Instead of coins, the machines accept and pay out tickets with specific dollar amounts—so casinos don't have to load up on coins. Casinos, such as Harrah's and Bally's Las Vegas have replaced some machines with IGT's new system. "We are seeing a snowball effect of casinos converting to cashless machines," says Steven Kent of Goldman Sachs, who has a target of 70 for 2001. IGT's sales and gaming operations, he says, should beat expectations in the next few quarters. He sees IGT earning \$2.70 a share in 2001 and \$3.10 in 2002.



IMCLONE MAY HAVE A CANCER BLOCKBUSTER

ImClone Systems (IMCL), a biotech outfit that focuses on cancer, was a big hit at the May 14 meeting of the American Society of Clinical Oncology. It presented findings from Phase II and III trials of its flagship product IMC-C225—for colorectal, head-and-neck, and pancreatic cancer.

"The data that ImClone presented substantiate our belief that c225 could be a blockbuster, with potential for \$1 billion in annual sales," says Cory Kasi-

mov, an analyst at Gruntal. A Phase II study of c225 in 120 patients with colorectal cancer, says Kasimov, showed a 22.5% positive response—surpassing an expected 17% rate and the 15% hurdle believed necessary for Food & Drug Administration approval. ImClone will file for approval in June. C225 has a fast-track designation, so it could get approved early next year.

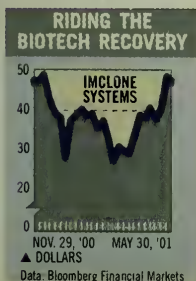
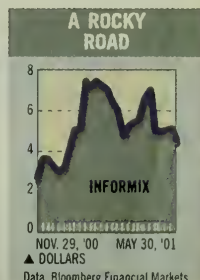
John McCamant, editor of *Medical Technology Stock Letter*, expects ImClone to seek a partner to fund c225's trials and co-market the product. Bristol-Myers Squibb is a potential ally, says McCamant, but the company might opt instead to acquire ImClone. Bristol-Myers needs a biotech with potential breakthrough products—and ImClone needs a deep-pocketed backer. For ImClone, McCamant has a 12-to-18-month target of 100—with or without a buyout. It is now 47.

Analyst Stephen Farinelli of Merrill Lynch expects ImClone to turn profitable in two years, earning 84¢ a share in 2003, and \$1.50 in 2004.

POTENT PARTNERS FOR INFORMIX

A curious thing happened after Apr. 24, when software maker Informix (IFMX) announced the sale of its database business to IBM for \$1 billion: Informix stock tumbled from 7 to 4 in two days. The Street felt that IBM got the operation on the cheap. But some pros are rethinking the deal—and snapping up the depressed shares. Their logic: Informix is left with a small but fast-growing unit, called Ascential Software. IBM and German software house SAP have formed alliances with Ascential, which some analysts call a leader on "information asset management"—software that helps companies maximize the usefulness of stored data. Ascential will develop and market its products with IBM's hardware and software platforms. With SAP, Ascential's products will be resold by SAP to its data warehouse customers. Aligning with these worldwide enterprise software vendors is a big plus for Ascential, says Mark Murphy of First Albany's FAC/Equities unit.

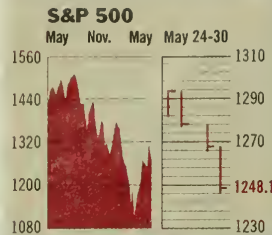
With no debt and \$1.5 billion in cash, or about \$4 a share, "Ascential's valuation is compelling," says Vincent Muscolino of David L. Babson Technology Fund. Its peers trade at 7 to 10 times sales while Ascential trades at 2 times. Sales are expected to rise 30%, to \$160 million, in 2001 and jump to \$230 million in 2002, says Muscolino.



BusinessWeek online

Read Gene Marcial's Inside Wall Street Online column Tuesday afternoons at www.businessweek.com/today.htm. And see him Fridays at 1:20 p.m. EST on CNN's *The Money Gang*.

Stocks



COMMENTARY

Now you see a rally, now you don't. A handful of profit warnings from blue-chips and techs got investors thinking that the recent rebound was too optimistic. Losses halted a seven-week rally that, for one, pulled the Nasdaq up 27% from a 52-week low on April 4. The tech index lost 7.1% this week. The S&P and Dow lost ground, too: down 3.2% and 2.1%, respectively.

Data: Bloomberg Financial Markets
Bridge Information Systems, Inc.

U.S. MARKETS

	May 30	Week	Year to date	Last 12 months
S&P 500	1248.1	-3.2	-5.5	-12.3
Dow Jones Industrials	10,872.6	-2.1	0.8	3.3
Nasdaq Composite	2084.5	-7.1	-15.6	-39.7
S&P MidCap 400	514.9	-3.4	-0.4	8.5
S&P SmallCap 600	223.8	-3.3	1.9	12.9
Wilshire 5000	11,527.1	-3.3	-5.3	-11.9

SECTORS

	May 30	Week	Year to date	Last 12 months
BusinessWeek 50*	865.2	-4.8	-10.8	-26.4
BusinessWeek Info Tech 100**	473.2	-9.3	-16.3	-46.8
S&P/BARRA Growth	616.5	-4.0	-10.3	-27.0
S&P/BARRA Value	631.0	-2.5	-0.8	4.7
S&P Energy	956.1	0.2	2.6	6.3
S&P Financials	158.6	-1.6	-3.7	15.1
S&P REIT	89.4	-0.5	1.7	13.5
S&P Transportation	729.9	-2.2	4.6	26.9
S&P Utilities	325.7	-4.2	-7.1	20.8
GSTII Internet	134.8	-9.8	-25.8	-68.6
PSE Technology	732.6	-7.9	-10.1	-27.3

*Mar. 19, 1999=1000 **Feb. 7, 2000=1000

BEST-PERFORMING GROUPS

	Last month %	Last 12 months %
Pollution Control	13.1	Engineering & Constr. 142.6
Toys	12.5	Tobacco 91.6
Engineering & Constr.	10.6	Homebuilding 70.9
Insurance Brokers	9.9	Savings & Loans 62.1
Alcoholic Beverages	9.0	Hospital Management 56.1

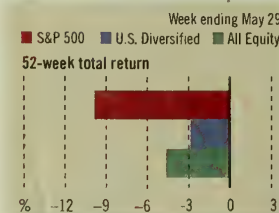
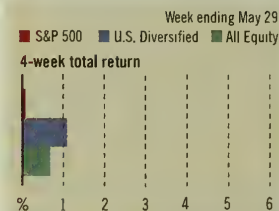
EQUITY FUND CATEGORIES

4-week total return	%	52-week total return	%
Leaders			
Precious Metals	7.3	Financial	28.2
Latin America	4.6	Small-cap Value	25.9
Health	4.2	Mid-cap Value	22.0
Small-cap Value	4.0	Natural Resources	20.9
Laggards			
Communications	-4.4	Technology	-39.8
Utilities	-2.9	Communications	-39.6
Technology	-2.6	Japan	-26.1
Europe	-2.5	Diversified Pacific/Asia	-20.4

EQUITY FUNDS

4-week total return	%	52-week total return	%
Leaders			
American Heritage	18.8	Schroder Ultra	107.6
Perkins Discovery	14.8	CGM Focus	76.5
Corbin Small Cap Value	14.5	Bost. Part. Sm. Cap Val. II	72.6
Investec Mainland China	13.1	Burnham Financial Svcs. A	70.5
Laggards			
Monument Telecomms. A	-11.0	Firsthand Communications	-66.2
Monterey Mur. N. Wild. Tech.	-10.6	ING Internet A	-65.5
Rydex Telecomms. Inv.	-8.8	Firsthand E Commerce	-65.4
Monument Digital Tech. A	-8.4	iShares D.J. U.S. Internet	-64.5

Mutual Funds



Data: Standard & Poor's

GLOBAL MARKETS

	May 30	Week
S&P Euro Plus (U.S. Dollar)	1200.0	-2.8
London (FT-SE 100)	5796.9	-1.7
Paris (CAC 40)	5444.3	-3.3
Frankfurt (DAX)	6041.2	-2.8
Tokyo (NIKKEI 225)	13,493.4	-4.1
Hong Kong (Hang Seng)	13,420.1	-3.0
Toronto (TSE 300)	8101.4	-3.0
Mexico City (IPC)	6586.9	-2.9

FUNDAMENTALS

	May 29	Week
S&P 500 Dividend Yield	1.24%	
S&P 500 P/E Ratio (Trailing 12 mos.)	28.9	
S&P 500 P/E Ratio (Next 12 mos.)*	22.3	
First Call Earnings Revision*	-1.06%	

*First Call Corp.

TECHNICAL INDICATORS

	May 29	Week
S&P 500 200-day average	1330.5	13
Stocks above 200-day average	72.0%	
Options: Put/call ratio	0.65	
Insiders: Vickers Sell/buy ratio	2.50	

WORST-PERFORMING GROUPS

	Last month %	Last 12 months %
HMIs	-15.0	Communication 10.0
Homebuilding	-14.4	Semiconductors 10.0
Dil & Gas Drilling	-12.6	Long-Dist. Tele 10.0
Semiconductors	-12.5	Instrumentation 10.0
Instrumentation	-11.9	Metal & Glass 10.0

Interest Rates

KEY RATES

	May 30	Week
MONEY MARKET FUNDS		
90-DAY TREASURY BILLS	4.21%	4.21%
1-YEAR TREASURY BILLS	3.67	3.67
10-YEAR TREASURY NOTES	5.51	5.51
30-YEAR TREASURY BONDS	5.85	5.85
30-YEAR FIXED MORTGAGE†	7.31	7.31

†BancQuote, Inc.

BLOOMBERG MUNI YIELD EQUIVALENT

Taxable equivalent yields on AAA-rated, tax-exempt bonds, assuming a 31% federal tax rate.	
10-yr. bond	
GENERAL OBLIGATIONS	4.47%
TAXABLE EQUIVALENT	6.48
INSURED REVENUE BONDS	4.59
TAXABLE EQUIVALENT	6.65

THE WEEK AHEAD

VEHICLE SALES Monday, June 4 ▶ Sales of U.S.-made and imported cars and light trucks probably totaled an annual rate of 16 million in May, according to the median forecast of economists surveyed by Standard & Poor's MMS, a division of The McGraw-Hill Companies. That sales pace would be down sharply from the April rate of 16.5 million and the first-quarter pace of 17.2 million. So far this year, lucrative dealer incentives and rebates have pushed vehicle sales consistently above expectations.

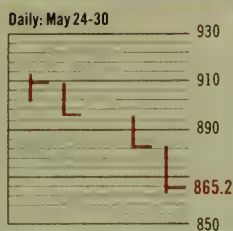
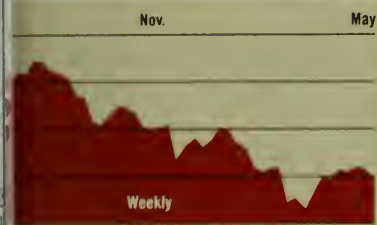
FACTORY INVENTORIES Tuesday, June 5, 10 a.m. EDT ▶ Manufacturing inventories were probably down 0.1% in April, after a 0.6% drop in March. April inventories of durable goods increased 0.1%, but falling petroleum inventories, a non-durable-goods item, are expected to help offset the advance in durables.

INITIAL UNEMPLOYMENT CLAIMS Thursday, June 7, 8:30 a.m. EDT ▶ New filings for state unemployment benefits likely remained above 400,000 for the week

ended June 2. Over the past jobless claims have averaged 400,000. The jump in claims shows the economy is loosening rapidly, as profits and economic growth continues to

INSTALLMENT CREDIT Thursday, June 7, 8:30 a.m. EDT ▶ Consumers likely took \$8.3 billion of new debt in April, up from \$6.1 billion in March. The rate of new installment credit slowed in the first quarter to \$11.5 billion per month, compared with \$12.8 billion per month in the

BusinessWeek Fifty



are sight among the BW 50 this week. The index slumped nearly 5%, with all sectors—financial, taking it on the chin. ADC Telecommunications fell 25% after the telecom-equipment maker lowered its third quarter forecast. Sun Microsystems fell 24% on similar news regarding fourth C shares got marked down 19% on concerns about the data-storage firm's pricing power.

COMPANY PERFORMANCE

% change			% change		
Week	Since 3/1/01	Rank	Company	Week	Since 3/1/01
onal	-2.9	3.1	26 Verizon Communications	0.6	11.5
oleum	-4.2	-1.9	27 Alza	-0.5	22.9
	-10.2	7.3	28 Citigroup	-2.4	4.4
	-11.3	3.7	29 Sun Microsystems	-24.4	-19.0
als	-7.5	8.0	30 Merck	-1.0	-8.1
ncial	-2.3	15.7	31 El Paso	-7.9	-15.8
troleum	-0.6	25.3	32 Altera	-15.7	-8.4
	-2.8	-0.3	33 Marsh & McLennan	-1.5	2.0
	-2.9	6.1	34 Household International	-1.0	12.7
ers Holdings	-13.8	-32.1	35 Chevron	1.8	10.4
	-9.1	5.5	36 SBC Communications	-1.4	-7.1
	-19.0	-27.9	37 Mercury Interactive	-13.5	0.7
ories	-6.5	-18.5	38 AOL Time Warner	-7.6	16.1
	6.4	10.2	39 Washington Mutual	-2.9	5.4
ncial	0.5	2.2	40 General Dynamics	-1.0	18.0
logy	-8.7	2.3	41 Comcast	-0.1	-4.1
	-9.3	-0.6	42 Morgan Stanley Dean Witter	-10.2	0.9
	-1.1	17.2	43 Tellabs	-15.8	-21.5
	-4.7	7.4	44 Exxon Mobil	1.8	9.2
unications	-25.0	-34.1	45 Scientific-Atlanta	-18.0	11.4
ncial	-5.6	17.6	46 U.S. Bancorp	-1.0	-4.9
um	-2.2	21.2	47 Paychex	-0.9	-0.1
	-12.8	5.6	48 Merrill Lynch	-5.9	7.1
	-3.8	3.1	49 Bed Bath & Beyond	-1.0	18.4
	5.1	7.5	50 Texas Instruments	-16.4	2.1

Production Index

Change from last week: -0.4%
Change from last year: 3.6%

OUTPUT May 19=173.4 1992=100



Sept. 2000 Jan. 2000 May 2001

x fell sharply in the latest week. Be-
e four-week moving average, the in-
4, from 174.1 in the May 12 week.
tments, auto and truck assemblies
e second straight week, along with
in coal and a drop in electric pow-
ic was also down, a by-product of
l production. Both steel and crude-
er.

ve index components is at www.businessweek.com
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BusinessWeek (ISSN 0007-7135) published weekly, except for one week in January, by The McGraw-Hill Companies, Inc. Executive, Editorial, Circulation, and Advertising departments are located at 1221 Avenue of the Americas, New York, N.Y. 10020. U.S. subscriber rate \$54.95/year; \$69/year. Periodicals postage paid at New York, N.Y., and at additional mailing offices. At Montreal, P.Q. Canada Post International Publications Mail Product Sales Agreement. Postmaster: Send address changes to BusinessWeek P.O. Box 430, Hightstown, N.J. 08520.

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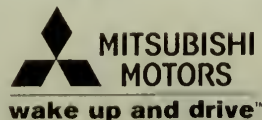
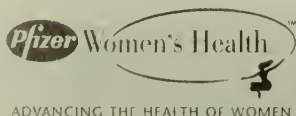


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THE TAX CUT: SMILE NOW, WORRY LATER

Now that the \$1.35 trillion tax cut is law and the emotional hoopla surrounding its passage is over, a closer look at the unprecedented bill reveals what may be a startling paradox: The big supply-side impact of the marginal, long-term cuts to income-tax rates will probably be less than predicted, and the smaller, Keynesian kick of the front-loaded rebates and withholding will be greater than expected. To policymakers worried about the current downturn, the unexpected stimulus is good news. But for investors and businesspeople and even consumers looking out to the future, the tax bill may well be disappointing. It dribbles out tax cuts, skips years, and automatically reverses itself in 2011. This uncertainty undermines its macroeconomic benefits. Smaller, permanent, predictable tax cuts almost always have bigger effects on investments than larger, uncertain, and possibly temporary tax cuts. A better tax bill would have put the surplus to better economic purpose (page 42).

First, the good news on front-loading. Thanks to pressure from Treasury Secretary Paul H. O'Neill, a one-time rebate check will be in the mail starting in July for \$600 to all married taxpayers and \$300 for singles. This reflects a cut in the bottom income-tax bracket from 15% to 10%, retroactive to Jan. 1, and puts serious money in the hands of some 110 million taxpayers, most of them low- and middle-income taxpayers, who are likely to spend it. It also does so much earlier than expected and in a form—a check—that many will find conducive to spending. When you add in the one-percentage-point cut in all other brackets this year, effective July 1, that will show up in lower withholding payments by September, it is clear that Washington is generating a powerful \$45 billion wave of stimulus for the third quarter. An additional \$65 billion will be injected next year. Together with the dramatic cuts in interest rates by the Federal Reserve,

the front-loaded tax cuts greatly help brake the do-

But the tax plan was supposed to do much more: change incentives and stimulate growth, thereby produce more tax revenues to pay for defense, education, and Security and Medicare reform. Accomplishing this, of course, requires predictability and consistency. These factors are lacking in the tax legislation. The law says that after a one-percentage-point cut this year, top-bracket taxpayers will wait three years, until 2004, for a cut to 37.6%, then two years, until 2006, for a cut to 35%. And, believe it or not, the bill says everything automatically reverses in 2011, with the top rate jumping back up to 39.6%. This sunset provision applies to the estate tax, which ends in 2010, only to be brought back to current law (55% for estates over \$1 million). The marriage penalty returns as well. This uncertainty surrounding the tax code sharply reduces its effect on investment. Will this scheme survive five Congresses and two Presidential elections intact? Perhaps. Will politicians running for office in 2008 extend the tax bill beyond 2010? Maybe. But what about actually going to make investment and spending plans on it? How can people make plans to pass on their businesses or their financial assets to their children under these uncertain conditions? No wonder professional estate planners are telling their clients to be cautious about the tax bill.

The great surprise of the Bush tax bill is that at the bottom end, it delivers. But at the top, where investment decisions are made, is a huge question mark. As Washington politicians celebrate their tax-cut victory, economic planners may soon discover it changes their lives very much at all. Indeed, with all the phasing in and out of tax breaks and grab bag of credits based on the vagaries of political expediency, the bill itself may make doing business and planning for the company's financial future more confusing and difficult.

TIGHT MONEY IS CHOKING EUROPE

The bottom appears to be falling out of Europe's economy. Stunned CEOs, especially those in high tech, are reporting diving profits. Growth is decelerating. The euro is weak. Unemployment is rising. And yesterday's brave talk of Europe not being affected by the U.S. slowdown is replaced by serious worry over how low Europe may eventually go. Unlike the U.S., Europe suffers from the twin burdens of heavy capital flight and second-rate monetary management.

The litany of unexpected drops in earnings eerily echoes what happened in the U.S. in the first quarter. Philips Electronics and Siemens on the tech side as well as steelmaker Thyssen-Krupp and car-glass manufacturer Pilkington are now warning of profit woes ahead. American companies in Europe, such as Sun Microsystems Inc., appear to have been taken by surprise as well.

The European Central Bank isn't doing much to help. A paltry 25 basis-point cut in interest rates. Indeed, it appears intent on fighting inflation rather than spurring growth. Higher European prices are due to energy and food (and disease), not rising labor costs. The tight ECB monetary policy is actually fostering inflation by slowing growth and weakening the euro, which raises dollar prices for imports, especially for U.S. companies.

Meanwhile, European CEOs are making a dash for corporate assets. Alcatel appears to have just missed buyout Technologies, while Vivendi Universal has gobbled up music operator MP3 and is poised to take publisher Hachette Mifflin. They're the latest companies to send their executives across the Atlantic because of low growth prospects.

There's no secret in knowing what needs to be done. The ECB just has to do it.



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THE WORLD'S BEST PERFORMERS

PAGE 91

AOL Keyword: BW

"The infrastructure of e-business has become a mission critical component of today's global enterprise," says The Aberdeen Group.

PUT LESS DELICATELY, an e-business without the right infrastructure is living on borrowed time. The promise of e-business – to cut costs, improve customer service and streamline business models – means nothing if your company's infrastructure isn't ready for it.

So what is it? Why do you need it?

Infrastructure is the great invisible enabler. The stuff behind the wall. Servers, software, middleware, routers, storage – the things people never see. It's end to end. Top to bottom. It's your e-business skeleton.

Yet most of it wasn't designed for e-business. And now the Internet's explosive growth, the sudden connection of every system to every other system, and advances like "always on" wireless devices are testing it in ways designers never imagined. When computers go down, it's inconvenient. If infrastructure goes down, e-mails bounce, systems crash and customers go elsewhere.

Is it a technical issue? Is it a strategic issue?

The issues of e-business infrastructure: how do I get 20 platforms to work together seamlessly? Can we handle 3 million transactions an hour? Is it more cost effective to connect 30 small servers or consolidate on one massive server? How fast can I deploy?

These are not just technology questions – they're questions at the heart of how a business is organized and operated. And the answers vary, depending on market conditions, industry type and company size.

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business issues and how technology impacts and shapes them.

Do small companies need to worry about infrastructure?

They do if they want to become big companies. Pity the CEO whose business strategy increases online orders by 500%, but whose infrastructure can't handle the systemwide chain reaction. IBM infrastructure solutions are flexible and scalable – whether we help you build one from scratch or rent it to you as an outsourced e-business package. Plan for growth or you may pay for the oversight.

What about Linux®?

IBM has committed thousands of developers and technical support experts to Linux for two reasons: choice and interoperability. Never again will you be forced to adapt your processes to the only software available. With Linux, you just adapt the software to suit. In addition, Linux loves all kinds of hardware. Such openness makes it easy for you to integrate disparate platforms and create single, seamless e-business infrastructures.

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We've worked with thousands of companies of all sizes in every industry to plan, design and build the infrastructure they'll need to be successful e-businesses. We're working to make it even easier. For a copy of our latest white paper, call 800 426 7080 (ask for infrastructure) or visit us at ibm.com/e-business



THE EVOLUTION OF A REVOLUTION

When we launched our Information Technology 100 list in November, 1998, we expected our annual snapshots of a fast-changing industry to be dramatically different from one year to the next. How different, we had no idea. Some of the changes we expected. There was no way Dell Computer Corp., ranked No.1 on that first list with revenue growth of 54% a year, could continue at that pace. Dell has shown up on every list, including the latest, our fourth. But it has slipped to No.34, with growth of 20.8%.

The most dramatic changes have involved the Internet companies. There were 16 on that first list, led by America Online. Some of the Class of 1998, such as Amazon.com Inc. and Yahoo! Inc., are struggling, while others have been acquired. This year's list has only one Internet company: Travelocity.com Inc., the travel site that is well on its way to profitability.

Our list, which was combined in 1999 with the Annual Report on Information Technology, has become far more, however, than a tabulation of who's hot and who's not. It has provided valuable clues to emerging and shifting trends in high technology. Insights gained from the list and annual report have become an integral part of our regular technology coverage.

In 1999, the list showed that the "arms merchants" of the Internet Age—equipment makers Cisco Systems, IBM, and EMC—were harvesting cash while the dot-coms burned it. Last year's list illuminated the trend toward providing technology as a service, whether information management, software applications, or storage and computing. This year's analysis is especially important because it spotlights the growing contribution of information technology to business efficiency.

Our annual reports, of course, are just part of our award-winning tech coverage—including our ahead-of-the-pack cover story two weeks ago on Microsoft Corp. We're especially proud of two other issues pictured here: "Are You Web Smart?" in our *BusinessWeek e.biz* supplement in September looked at the impact on the users of information technology. And our "Rethinking the Internet" in March measured the enduring force of the Net on traditional corporations, even as the dot-com phenomenon fades.

So to get a sense of what to expect from high tech, be sure to read our special report starting on page 91. Besides gaining insight into the efficiency promised by high tech, you will meet some unfamiliar companies and get an investment idea or two. Then check out www.businessweek.com, where our online staff will profile more companies from the list and provide in-depth interviews with executives who are buying and selling technology. Since we only do this once a year, we want you to have plenty to chew on.



Stephen B. Siegel

Editor-in-Chief



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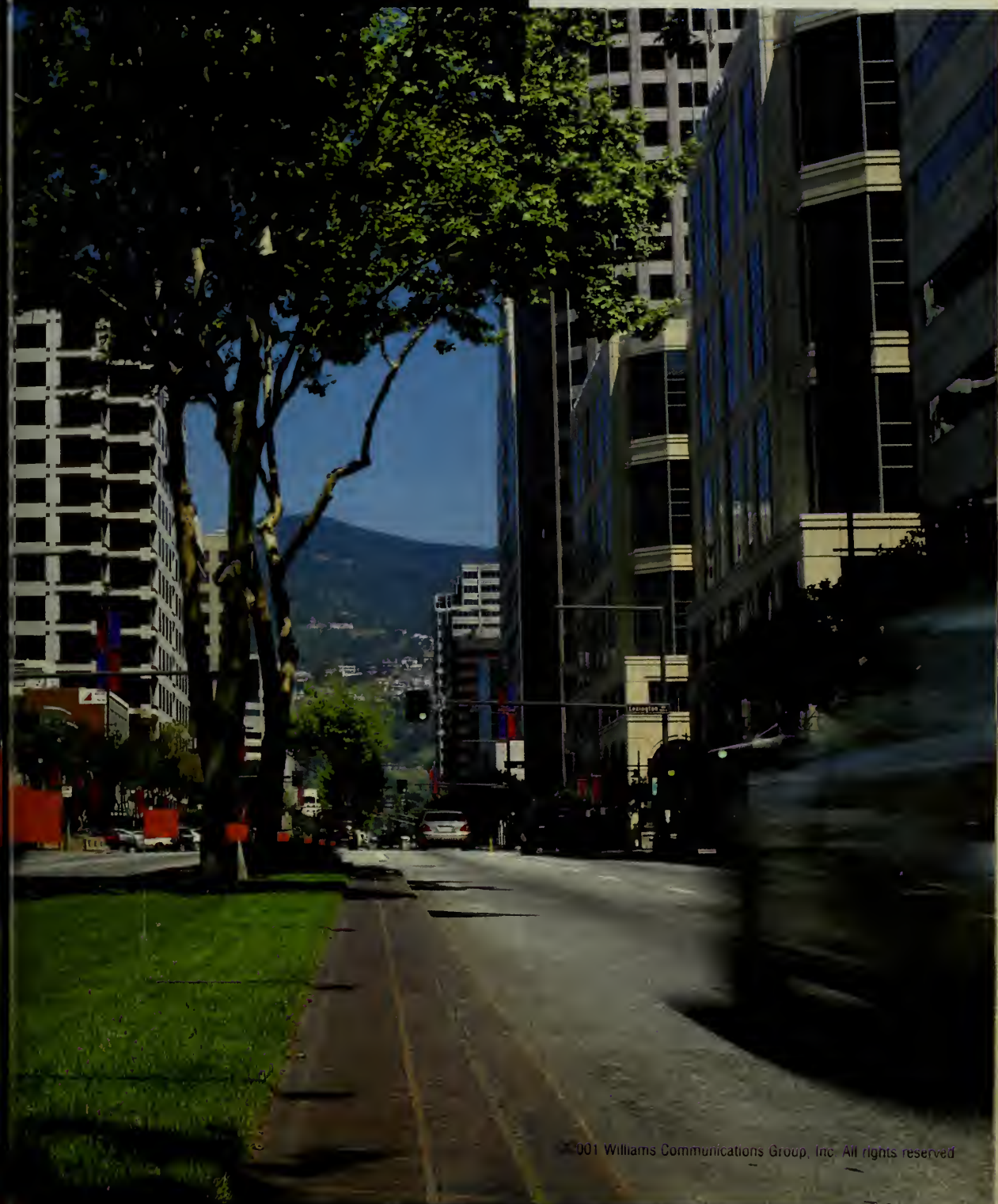


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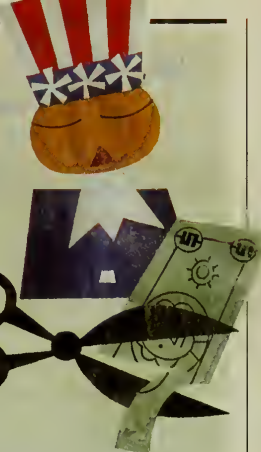
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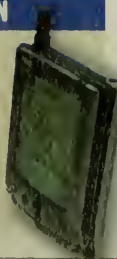


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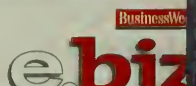


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WHEN THE CHECK WILL BE IN THE MAIL

IF YOU'RE WONDERING WHEN to expect that promised tax refund from Uncle Sam, check the last two digits of your Social Security number. If they fall between 00 and 09, you'll be among the first to get your check. Expect it

sometime after July 20. However, if your Social Security number ends closer to 99, don't spend your \$300 just yet—you won't be getting it until late September, earliest.

President Bush's tax plan, approved in late May, left the feds with the task of figuring out how to issue 98 million refunds. They couldn't do it by the first two digits of people's Social Security numbers, they decided, because that would favor people born on the East Coast, where SSN's begin with low numbers. So they decided to go by the last two digits, which are more randomly assigned. "This is the most efficient way of getting the checks out the door," explains a Treasury Dept. spokeswoman. With the government dispersing \$38 billion, efficiency matters.

Laura Cohn

THE LIST STOCK PICKS? ASK BILL

Forget eBay and Yahoo! For his own portfolio, Bill Gates prefers low-profile, traditional companies. While he has picked some dogs, his 14* publicly reported major holdings rose an average 10.9% this year, compared with the S&P 500's dismal -4%.** Here are his better picks:



STOCK	YEAR-TO-DATE %	VALUE OF GATES'S SHARES** MILLIONS
CANADIAN NATIONAL RAILWAY	+42%	\$422.3
North America's sole transcontinental rail		
PUBLIC SERVICE CO. OF NEW MEXICO	+37.8	86.6
Utility generates, transmits electricity		
SEATTLE GENETICS***	+28.6	31.7
Develops antibody-based drugs to treat cancer		
ICOS CORP.	+28.1	334.4
Washington state developer of Viagra rival		
NEWPORT NEWS SHIPBUILDING	+23.5	164.5
Designs, builds, maintains naval aircraft carriers, nuclear subs		
PAN AMERICAN SILVER CORP.	+20	9.2
Mining, principal property in Peru		

* Excludes Mar. 31 disclosure of holdings of more than 5% in compliance with SEC requirements. ** Value as of market close on June 4. *** Traded as of Mar. 6.

Data: 21st Century Investor, Bloomberg Financial

TALK SHOW "When you write something, you look at it the next morning and think, 'Boy, is this ugly.'"

—General Electric's Jack Welch, on his upcoming book, *Jack: Straight From the Gut*

JIVE MASTERS

GREENSPAN JUST CAN'T HELP HIMSELF

EVER FIND THOSE SNATCHES of televised testimony by Fed Chairman Alan Greenspan a bit difficult to follow? You're not alone. Even the man himself knows he can be nearly incomprehensible. "I used to be concerned that I would be inadvertently clear," he quipped to 1,500 black-tie dinner guests of the Economic Club of New York in late May. "But then I noticed that people had little Fed-speak dictionaries" to help them cut through "some of the obscurity with which I have become well-versed."

The crowd chuckled appreciatively at Greenspan's self-deprecation. But that didn't save them from the circumlocution to come. In tracing recent economic history, Greenspan offered such nuggets as: "The persuasive evidence that the growth of structural productivity re-



UNWORRIED about clarity

mains well maintained, that prospective long-term rates of return probably have been only marginally diminished suggests a solid underpinning to capital spending.

When he was done, someone asked Greenspan whether he thought the tax cut conflicted with the Fed's monetary policy. "There has got to be some way to answer that question without saying anything," he replied. Then, of course, he found it. Carol Marie Cro-

HACK ATTACK

TAKE THAT, RUNNING DOG FILE SERVER

CHINESE HACKERS, UPSET over the American spy-plane incident earlier this year, have been attacking U.S. government Web sites since April. According to official U.S. accounts, they've merely managed to post anti-American graffiti but not much more.

However, cyberhooligans did score a direct hit on one of several e-mail systems used by the State Dept. The strike knocked out an unclassified service used for external

communications by public relations officers in Washington who communicate with U.S. embassies worldwide. The incursion penetrated four State Dept. file servers, affecting e-mail addresses ending in ".pd.state." Sources at the U.S. Embassy in Tokyo tell *Business Week* that hackers sympathetic to China are suspected.

Service has been partially restored, but many diplomats still must do with alternative addresses in some of their personal Hotmail

Yahoo! accounts. Strife over Taiwan trade flare again, and more fireworks from Chinese hackers. Chester D.



Just because you're good at one thing doesn't mean you're good at everything.



Shaquille O'Neal is an unstoppable force in the world of basketball. But the skills that make him a phenomenon on the court don't ensure success in other endeavors.

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Up Front

FLEETING FAME

TONY SOPRANO ATE HERE (SORT OF)

THE THIRD SEASON OF *THE Sopranos* ended with a bang in May. Yet for some New Jersey businesses featured in the HBO hit, the boom continues. The dozens of restaurants and stores, used to give a realistic view of the Garden State, are profiting from their newfound celebrity and becoming tourist attractions.

At Fountains of Wayne, a patio and garden store, customers "constantly" mention the store's March cameo, says manager Brian Winters. Although he can't estimate the financial impact of the appearance in which Tony Soprano buys (you guessed it) a fountain, he



TOAST OF JERSEY CITY

says the value of the free advertising far exceeds the \$8,000 HBO paid to use his store. "The show made it easier for new customers to identify us," says Winters. Adds Joe LaSpaba, whose Joe's Bake Shop in North Arlington appeared in the first season: "That's kept us going for two years now."

Sopranoland sites will soon get more visitors, courtesy of Georgetown Blau, whose On Location Tours runs buses to Satin Dolls nightclub (screen name: Bada Bing) in Lodi, North Arlington's Pizzaland, and Jersey City's Skyway Diner. Blau says more than 1,500 people have taken the \$30, Sunday-only tour: "We're starting weekday tours to accommodate summer demand, and we haven't even done any advertising yet." *Brian P. Murphy*

BLACKOUT BLUES

KEEPING TABS ON THE POWER SUPPLY

WITH CALIFORNIA'S POWER supply stretched to the limit and the prospect of blackouts looming, a government research lab is offering a way to keep constant tabs on the

tion schedules as demand nears capacity.

The brand new Web site, energycrisis.lbl.gov, created by scientists at federally funded Lawrence Berkeley National Laboratory, tracks California's actual power consumption in real time. It then creates simple-to-read line graphs showing how close the state is to maxing out and updates them every 10 minutes. "People can learn to respond to when the peak is occurring and when they should get their equipment switched off," says longtime power-conservation researcher Alan Meier.

Meier cautions that his site can't show where blackouts will happen, just that they will. "I created this because I couldn't tell when we were nearing a serious situation," he says. Now he can—and you can, too. *Alex Salkever*



HIGH USE? Check the Web

situation. That way, people can see whether they need to break out the flashlights and crank up the generator and businesses can prepare to adjust work and produc-

DRAWN & QUARTERED



"GENTLEMEN, WE'VE ACHIEVED THE ULTIMATE: NO CASH-FLOW WORRIES, NO CREDIT WORRIES, NO DOWNSIZING, NO LAGGING SALES—WE'RE BANKRUPT!"

MOM WAS RIGHT

YOUR WALLET IS A BIOHAZARD

DOES OUR MONEY NEED TO BE laundered? You might think so after hearing from Peter Ender, chief of infectious diseases at Dayton's Wright-Patterson Air Force Base. He has come up with yet more proof that money is disgustingly filthy.

Ender, who with his researchers collected 69 \$1 bills from businesses in Dayton, found five had bacteria (*Staphylococcus aureus* and *Klebsiella pneumoniae*) that could infect healthy people—if the bills touched the mouth or an open cut. Another 59 bills had a variety of germs that "have been known to cause significant infections in those with depressed immune systems," says Ender. He presented his findings to the

American Society of Microbiology meeting in Orlando in May.

But Fred Weinberg, a currency expert and president of the Professional Numismatists Guild, scoffs at the idea of money as a health issue. "I have been doing this for 30 years, and I never heard of anybody got sick from handling \$1 bill."

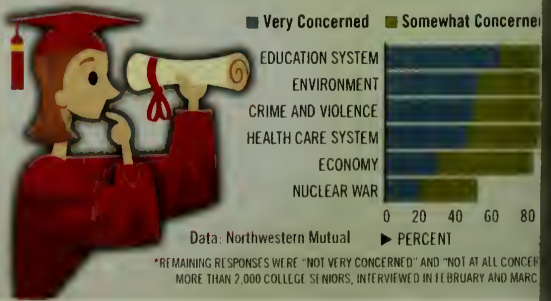
Even so, your mother's right: Wash your hands handling cash. *Dennis F.*



THE BIG PICTURE

THE FIRST COLLEGE GRADS OF THE MILLENNIUM

Most of the Class of 2001 believes the nation is "on the right track." But when asked, they do have some worries.



FOOTNOTES Adults polled who say they are baseball fans: **58%**; of those, ones who have "called in sick" to attend a game: **1**



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DARTS AND LAURELS FOR TYCO'S CEO

"The most aggressive CEO" (Cover Story, May 28) is of particular interest to me as a longtime Tyco International admirer and current shareholder. CEO Dennis Kozlowski, with an enormous ego, obviously is very talented and determined. He also must be very greedy. According to the proxy for the 2001 annual shareholders meeting, Kozlowski is assured of a pension at age 65 of \$315,983 per month, which is several times his [base] salary. In addition, Tyco pays fees to its directors who also are its employees. In 2000, Kozlowski received for his services as a director the sum of \$65,000. I'm waiting a while longer for the stock to go up and then will sell it at a profit and move on to something else.

Paul R. Steyermark
 Wilmington, Del.

Tyco's CEO deserves more than the story presented by *BusinessWeek*, which leans toward the camp of skeptics. First, Tyco is not only an aggressive acquirer but also a structural growth company, given its 10%-plus organic sales growth the last few years. Second, you quote analyst [David Tice], who has accused Tyco of accounting irregularities ("There will be a stumble, and it's coming soon") without asking him to explain this negative view if he can, which I doubt. I miss the comments of the majority of analysts, who rate Tyco a "strong buy."

Third, calling [flat sales] on a sequential basis for its electronics unit "a spectacular slowdown" while technology is falling off a cliff is beyond reality.

Cisco Systems, for example, shows 30% decline in sequential growth—a spectacular. So far, Kozlowski has ways delivered what he has promised.

Vincent K.
 Amster

Our society is already more than with an oversupply of aggression. popularizing this undesirable quality putting it on a pedestal.

E.C. Wei
 Lansdale



DISSECTING DANGERS OF A 'LIVING WAGE'

I found it interesting "What exactly is a 'living wage'?" was followed by Detroit, the engine of the 1930s" (Social Issues, May 28). As the economic development director for

on, Ohio, where a living-wage ordinance was defeated recently, it is no surprise to me that in Detroit, where a living wage ordinance has been in effect several years, the local economy is thriving. As we went through the downturn here in Marion, company after company told us they would not consider locating in our community with such an ordinance in place. Our city council, with wisdom, preferred to keep Main doors open to new investment and the marketplace set wage rates. Healthy competition for workers, we've seen average wages increase significantly on their own.

Dave Clark
 Marion, Ohio

A more beneficial approach to the problem of how to boost pay for low-income workers would be for governments targeted by living-wage

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JUNE 18, 2001 (ISSN 0007-7135) *** 3737
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CORRECTIONS & CLARIFICATIONS

In "Sandy Weill wants the world" (Finance, June 4) about Citigroup, Poland's Bank Handlowy was described as a retail bank. It is both a corporate and retail bank. In the accompanying table, Bank Handlowy's price should have been \$1.2 billion.

"Asia: The new U.S. strategy," (International Business, May 28) should have read: "... Tokyo Governor Shintaro Ishihara, one of Japan's most popular politicians..."

"Congratulations, grads—you're bankrupt" (News: Analysis & Commentary, May 21) incorrectly reported that between 1991 and 1999 bankruptcy filings by Americans 25 and under increased 51%. The correct figure is 96%.

cates to take the money that it would cost to adopt living-wage rules and use it to pay—through vouchers or other means—for worker education, training, and other ancillary programs for living-wage candidates. Increased education and training has been shown indisputably to have the single highest correlation with an increase in economic opportunity and income.

Matthew I. Slavin
Sacramento

I suspect I am not alone in wishing you wouldn't presume that taxpayers have bottomless pockets from which government programs can be funded.

David L. Goodwin
Rockville, Md.

IMMIGRATION IS NO SUBSTITUTE FOR GOOD GOVERNMENT

Gary Becker's "How rich nations can defuse the population bomb" (Economic Viewpoint, May 28) sounds like a recipe for impoverishing the developing countries even more. For years, economists have argued that the single most important factor in economic development is human capital/skilled labor. Does the brain drain from poor countries have to be elevated to policy status?

Samuel K. Andoh
Hamden, Conn.

MORE MAC FANS TAKE A CRINE TO APPLE

Garry, Steve: Here's why it won't work! (New Analysis & Commentary, May 21) may have missed the point about the Apple Computer Inc. stores. Apple is

not trying to sell a computer. It's selling a better computer. Apple needs to show its products in a controlled environment, since Apple is pretty much invisible in normal computer stores. The goal is to raise brand awareness and pull in new customers. As for secretiveness, a little mystique is always good for marketing. If some retailers aren't smart enough to clear out inventory when Apple stops filling orders, maybe they should stick to PCs. As far as I can tell, every Mac fan Web site knows about a month in advance when a new product is coming.

Matthew Woody
McAllen, Tex.

Do I have a gripe? Yes! I was called by your reporter for comments on Apple's retail plans, and I said I wasn't aware of such plans and that I wasn't in any position to comment. Your reporter and I had a wide-ranging discussion about issues affecting the personal-computer industry (including Apple). I never said: "Apple's problem is it still believes the way to grow is serving caviar in a world that seems pretty content with cheese and crackers." I do not have any "gripes" about Apple, Steve [Jobs], or his management team. As I have often said, Steve's ability to surprise us all with his plans for Apple should never be underestimated.

Joseph A. Graziano
Saratoga, Calif.

Cliff Edwards' commentary cites outsiders as saying Apple should be exploring new markets instead of developing stores. Since Apple has only 5% of the computer market share, I can't think of a bigger market to go after than the remaining 95%.

It appears that the Mac dealers aren't doing their jobs—so Jobs is!

Tony Lariccia
Erie, Pa.

WHY YAHOO HAS TO GET IN THE FAST LANE

"Inside Yahoo" (Cover Story, May 21) cites the example of Yahoo's ownership of Broadcast.com's streaming media content distribution, while pointing out that only a very few Internet users have fast enough connections to enjoy such a luxury. Yahoo may be short on cash, but it needs to purchase a high-speed Internet company. This would help Yahoo establish a customer base that would pay more to experience all that Yahoo has to offer.

Andrew C. Slay
Richmond, Va.

LEAVE FOREIGN POLICY TO THE FREE MARKET

Bush and his conservative friends ten place free-market forces high above government interference in social policy. "What business should be telling President" (Economic Viewpoint, May 14) [is that] in international affairs, the same economic dynamics are far more potent and effective than unnecessary political confrontations in helping secure long-term productive and peaceful relationships with countries such as China. Qiming? Hamden, Conn.

SIMPLICITY IS DRIVING GROWTH AT UPS

United Parcel Service Inc. has increased its overnight and second-day air business by simply having the service truck pick up and deliver air-ground packages ("Ground wars," Industries, May 21). Ground and air packages are done on the same manifest compared with two manifests with shipping with FedEx Corp., which has separate trucks handling its air-ground packages. UPS's model is more efficient and has lower costs, but it's the customers who ultimately benefit.

Jerome R. Butler
Coconut Creek, Fla.

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BY JEFFREY E. GARTEN

GEORGE BUSH ON TRADE: IS HE ALL TALK?



HURDLES:
There's plenty at stake in the upcoming summit, but the Bush team faces major obstacles in bringing home any new accords

Jeffrey E. Garten is dean of the Yale School of Management. A former investment banker, Garten is the author of *The Mind of the Market*. (jeffrey.garten@yale.edu)

Steve Case, chairman of AOL-Time Warner Inc., once told me that a vision without the ability to execute it is a hallucination. This could describe the Bush Administration's trade policy, which will be highlighted when the President meets with European leaders in Sweden on June 14 and attends the G-7 summit in Italy on July 20-21. To be sure, he and his chief trade negotiator, Ambassador Robert B. Zoellick, will give the right signals. They have already advocated more economic integration with Mexico and freer trade throughout the hemisphere. They have announced support for new global negotiations. And they are sure to propose expansion of commerce across the Atlantic. But once the speeches end, will concrete results follow?

A first hurdle is securing "fast-track" authority—by which Congress agrees that it will either pass or reject accords that the executive branch negotiates and not allow crippling amendments. Unless such legislation is passed, other countries will not negotiate with the Administration for fear their deals will unravel on Capitol Hill. Many in Congress are making fast-track contingent on Bush's agreeing to include labor and environmental standards in the accords, as well as provisions permitting trade retaliation when such standards are violated. No developing country will agree to such conditions, and the Administration is rightfully looking for an alternative. But given Bush's low credibility with American environmental and labor groups, not to mention a Senate now controlled by the Democratic party, a solution seems remote.

HERCULEAN. Another obstacle concerns the political priority the Administration will give to trade even if it gets negotiating authority. Education, energy, the environment, military modernization, and judicial appointments are already overcrowding the agenda, and Washington has yet to tackle Social Security reform and the soaring cost of health care. It will take a herculean effort to handle the expanding number of trade issues, which include traditionally sensitive problems such as agriculture, steel, and textiles, but also extend to financial services, information technology, biotechnology, intellectual property rights, and the rules governing the World Trade Organization. It will also require deft political coalition building in Congress. If the tax bill is any example, this is a skill the Administration has yet to demonstrate.

Third, polls show nearly half of all Americans believe free trade is harmful, even though exports have fueled about 25% of U.S. economic

growth in the 1990s and supported million high-paying jobs, and although imports have been a major factor in holding prices down. So far, a sustained grassroots campaign, which the Administration shows no sign of conducting this time of economic slowdown, the difficulty of gaining public support for more trade agreements will only mount.

Nor is it possible to discern any Administration strategy towards two other critical groups. Developing nations feel that the industrial countries have not made good on previous commitments to lower trade barriers. And many of the governmental organizations, such as Friends of the Earth, are determined to prevent future trade talks from succeeding.

MEAGER BENCH. The President needs more high-level help, too. When Bill Clinton came into office, for example, chief negotiator Mickey Kantor was complemented by Secretary of the Treasury Lloyd Bentsen, a former senator with extensive trade expertise, and National Economic Council chair Robert E. Rubin, a global investment banker for decades. He also got help from the Council of Economic Advisers Chief Laura D'Andrea Tyson (a current Viewpoint columnist), Labor Secretary Robert Reich, both of whom had written about global economic competition since the early 1980s, and Commerce Secretary Ron Brown, who had a passionate interest in economic development at home and abroad. In addition, Clinton had a supporting cast of globally renowned economists, including Lawrence H. White, Alan Blinder, and Joseph Stiglitz. The Bush bench does not have comparable depth.

The overall international picture won't be helped by the Administration. If the European Union implements its threat to levy \$4 billion of penalties against the U.S. for our income-tax subsidies to American exporters, a trade war may erupt. If Japan is to recover, domestic deregulation will have to be accompanied by large increases of Japanese exports, stoking protectionist sentiments in importing nations.

The WTO is predicting that trade this year will grow only 50% as fast as it did in 2000. A failure of the Administration to deliver on trade liberalization could make matters worse. The stakes are bigger than just an expansion of commerce and include continuing the momentum for political openness and individual freedoms around the world. Rhetoric unaccompanied by implementation would be a real debacle. I hope I'm wrong, but unfortunately that's what could be in store.

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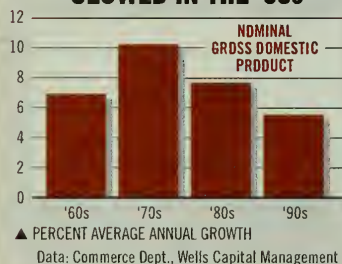
THE BOOM THAT CONCEALED A BUST

A provocative view of the 1990s

Although Americans tend to view the past decade as a period of robust growth, the reality, contends economist James W. Paulsen of Wells Capital Management, was far different. The distinguishing characteristic of the U.S. economy in the 1990s, he claims, was not a consumption boom but underlying weakness in demand from consumers, business, and government.

Paulsen advances the provocative the-

HOW DEMAND GROWTH SLOWED IN THE '90s



sis that the miracles of the '90s—low inflation, improving productivity, widening profits, surging stock prices, and the longest expansion in history—were actually the result of sluggish growth in U.S. and global demand. What enabled U.S. business to thrive in this environment was the energetic adoption of a number of cost-cutting strategies that went straight to the bottom line.

The most startling aspect of the 1990s, says Paulsen, was the absence of strong “top-line” growth, or sales increases. Among the Group of Seven industrial nations, nominal gross domestic product (a good proxy for an economy’s total sales) rose just 4.85% a year—half its rate from 1960 to 1990. In the U.S., nominal GDP grew at a mere 5.54% annual rate, its slowest pace since the Depression, while real growth was no higher than in the 1980s and actually lagged behind the pace of both the low-inflation 1960s and the high-inflation 1970s.

One reason for this slowdown is a sharp decline in advanced nations’ demographic growth. Another is a major contraction in overall U.S. debt growth from an average 15% annual increase in the mid-1980s to roughly 5% at last

count. Finally, policymakers stopped relying on massive federal outlays and programs to prop up demand.

As it turned out, says Paulsen, weak demand growth proved beneficial in many ways. By curbing inflation, it kept the Fed from hitting the monetary brakes, thus prolonging the expansion and allowing unemployment to reach new lows.

At the same time, it forced companies to cut costs to bolster profits, inspiring such strategies as downsizing, restructuring, and outsourcing. And it accelerated the adoption of productivity-enhancing new technology, which added fuel to the stock market boom.

Paulsen claims the current slowdown has exposed the basic sluggishness of demand growth in advanced nations. The key question, he says, is whether such weakness can once again inspire actions leading to economic strength.

For U.S. business, he sees a mixed outlook. Some strategies, such as restructuring, downsizing, controlling inventories, and using contract workers, have either been exhausted or face diminishing returns, he says. But the ongoing technology revolution could still pay off big once the economy picks up.

For U.S., European, and Japanese policymakers, however, the message is clear: The underlying weakness of global demand due to demographic and other factors suggests that fears of inflation are excessive and that it’s time to use both monetary policy and even fiscal policy to promote growth.

CHEAP BOOKS ON THE WEB? FICTION

Prices haven’t been cut to the bone

When online retailing became a reality, many economists saw it as a boon for price-sensitive consumers. As buyers began using shopping engines to check prices at e-tailing sites, they predicted that e-tailers would be forced to lower prices close to their marginal costs to retain customers. They also expected prices to drift lower and the differences between prices to narrow.

In a recent National Bureau of Economic Research study, Karen B. Clay, Ramayya Krishnan, and Eric Wolff of Carnegie Mellon University tested these ideas by examining pricing practices by 32 online bookstores from mid-1999 to January, 2000. They tracked prices of books on *The New York Times* best-seller list, best-selling computer books, and a random sample of other books.

The results suggest that e-tailing parts significantly from the more near-perfect competition. While counts on some books, especially by sellers, were larger on the Web than regular stores, e-tailers’ prices did fall over the period studied and price differences did not narrow.

In fact, prices of the *Times* best-sellers and random titles both tended to rise a bit. Apparently, some e-tailers under pressure to become more profitable, realized they could lower their discounts and still attract customers.

The results imply that there will continue to be a lot of book price variation on the Web, a fact that should appeal to cost-conscious buyers. And there also be a wide variety of sellers—specializing in particular kinds of books or offering services such as book reviews or gift advice that customers value more than rock-bottom prices.

A WELCOME FLOW FROM CHINA

American outfits are raking it in

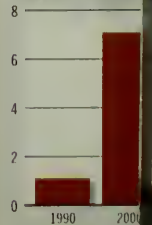
A common view is that U.S. companies in China earn little money there, and that the near-term benefit to trade are totally biased toward China. Not so, says Joseph Quinlan of Morgan Stanley, who notes that greater China (the mainland plus Hong Kong) represents the largest source of income for U.S. affiliates in developing nations.

From 1990 to 1998, reports Quinlan, the number of U.S. majority- or minority-owned subsidiaries in China jumped from 45 to 335, and the number of Chinese workers on their payrolls rose to 180,000. At the same time, surging direct investment helped lift the assets of such companies from \$2 billion in 1990 to nearly \$25 billion by the end of the decade.

The upshot is that greater China accounted for almost 40% of total U.S. foreign affiliate earnings from non-Japan Asia last year. In fact, the \$7.1 billion in income it provided to U.S. multinationals topped the earnings they received from Mexico and Brazil combined.

A WELCOME FLOW FROM CHINA

U.S. CORPORATE INCOME FROM AFFILIATES IN CHINA



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FROM THOUGHT TO FINISH.™

BY STEPHEN H. WILDSTROM

tech&you@businessweek.com

TEARING DOWN THE WIRELESS BABEL



The demise of one of the four U.S. cell-phone technologies is a sign of progress

The U.S. government's reluctance to meddle in technology has generally served both the industry and the public well. Wireless phones are the glaring exception. Laissez-faire has produced a digital Babel. Whereas governments in other countries have mandated a single standard, U.S. carriers offer four incompatible digital technologies operating at different frequencies (table). And with carriers all concentrating their efforts on the same lucrative urban markets, none can offer anything close to true national coverage.

There are signs, however, that market forces are finally taking hold. Global consolidation and the demand for moving data as well as voice are forcing a rationalization of U.S. networks.

The most important development is the coming demise of one of the main digital wireless technologies in the U.S. As part of a complex deal in which Japan's NTT DoCoMo took a \$10 billion stake in the company, AT&T Wireless will phase out the technology it uses, called time division multiple access (TDMA), in favor of the global system for mobile communications (GSM) standard used in most of the world. Cingular Wireless, which offers TDMA as part of its pastiche of networks, is also expected to move to GSM.

TDMA was probably doomed, anyway. It is a voice-only technology—in a market where data transmission, whether for Web access or wireless laptops, is a big concern for both carriers and their customers (Technology & You, June 11). Meanwhile, GSM, heretofore a bit player in the U.S., is poised to be one of the key survivors. Its position has been further strengthened by Deutsche Telekom's acquisition of VoiceStream, the leading U.S. GSM provider. In the future, most of the market will be split between GSM and CDMA, offered by Sprint PCS, Verizon Wire-

less, Alltel Communications, and Qwest. Net will continue to offer a specialty service to businesses that value its phones' distinctive ability to emulate push-to-talk two-way radios. And the original analog cellular network will stay in place indefinitely.

Ideally, consumers need not know or care about the technology, but these changes are important. With bigger carriers using fewer technologies, coverage should improve, leading to solid nationwide availability of GSM and CDMA. The fact that some services run at 800 megahertz and some at 1,900 Mhz is less important; it's easier to build a dual-band handset than to build one that uses different basic technologies.

POKY. A second benefit will be much-improved data service on browser-equipped phones, handhelds, and laptops that use the phone network. Currently, GSM and CDMA systems carry data at 14.4 kilobits per second, and even that rate is rarely achieved. Furthermore, the phone network is very inefficient for data. Even the data usually move in brief bursts, current technology requires that an entire voice channel be devoted full-time to each data call.

GSM carriers in Europe are rolling out a service that speeds up the system and lets multiple data transmissions share a single voice channel. In addition to offering speeds up to 64 kbps, the new system connects without the delay now required to set up a voice call. Greater efficiency should translate to lower prices. In South Korea, which has an advanced CDMA network, carriers are deploying a similar, somewhat faster technology.

Farther down the road, the wireless industry promises broadband service. Called 3G, the third generation, it will let you watch video on your phone, if you have your idea of a good time. But European carriers spent so much on the 3G licenses that they may never make money off the service. And the U.S. has yet to allocate spectrum for 3G.

Those are problems for the distant future. Meanwhile, more modest system upgrades—the works representing vast improvements in wireless data and, by luck, they will start to show up in the next year: I, for one, will be delighted to see a wireless service that is simple and widely available, even if it is no faster than dial-up modems.



Will CDMA and GSM Resolve the Wireless Mess?

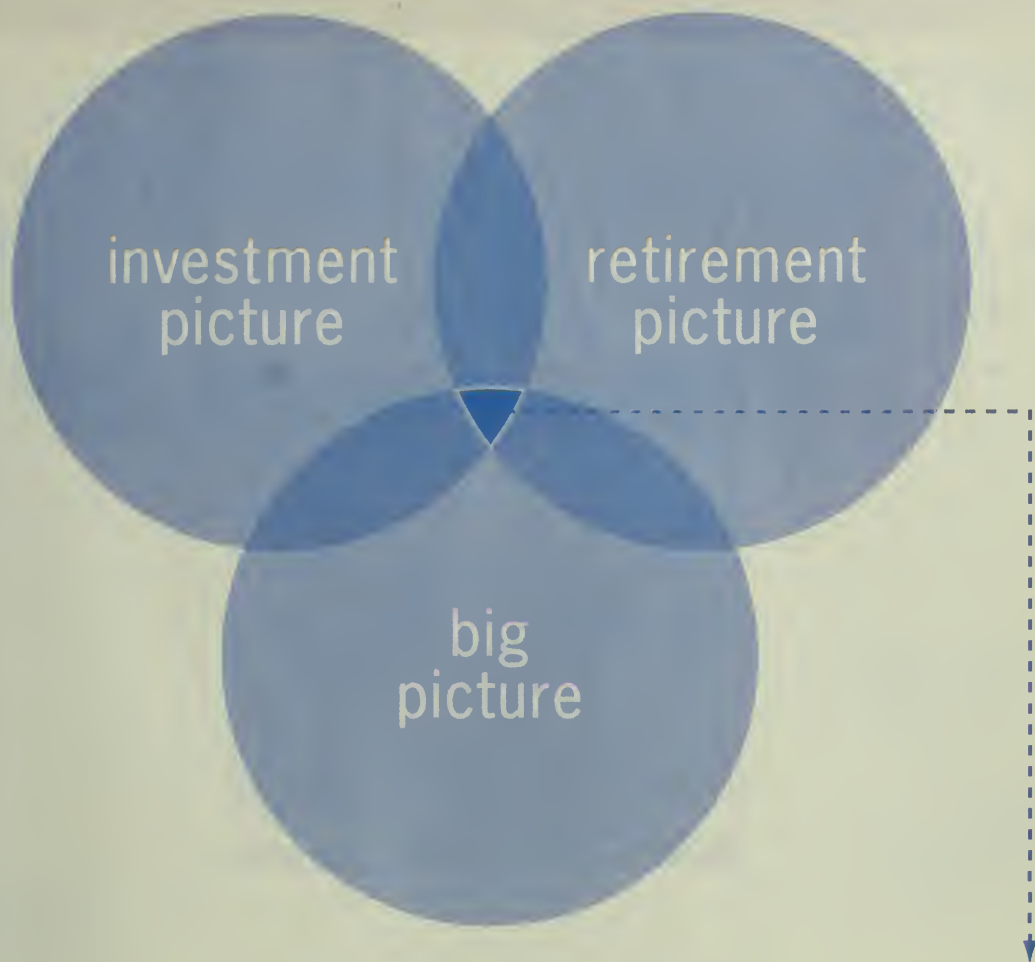
TECHNOLOGY	FREQUENCY	LEADING CARRIER(S)
CDMA	800 MHz 1900 MHz	Verizon, Alltel Sprint
GSM	1900 MHz	VoiceStream, Cingular
IDEN	800 MHz	Nextel
TDMA	800 MHz 1900 MHz	Cingular AT&T

Data by...

BusinessWeek online

THE IDEAL STUDENT

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THE PROVING GROUND

By G. Bruce Knecht
Little, Brown • 295pp • \$24.95

FATAL STORM

By Rob Mundle
McGraw-Hill • 272pp • \$12.95 paper

KNOCKDOWN

By Martin Dugard
Pocket Books • 243pp • \$13.95 paper

YACHT RACING'S DEBACLE DOWN UNDER

Blue water sailing is as different from coastal sailing as a Himalayan expedition is from backpacking in the Rockies. That's easy to forget in a season like this past one, when some 95 climbers summited Mt. Everest and when there were no catastrophic international sailing events. On a cloudless day, with a mild sea and a forgiving wind, a big offshore race can seem like a run across the bay. It's weather that makes the disasters and the best-sellers, from *Into Thin Air* to *The Perfect Storm*. In 1998, Australia offered the whole shebang.

Each year, starting the day after Christmas, fathers, sons, and grandsons compete in the classic Sydney-to-Hobart race, sometimes called the Everest of Australia. They cover a 630-nautical-mile course that leaves Sydney Harbor and ends in Hobart, a port on the island of Tasmania. Families fly in for the finish, everyone drinks a lot, and runners-up spend a year plotting how to edge out a friend or a neighbor.

In 1998, with the race in its 54th running, the start was auspicious. One hundred and fifteen yachts left Sydney Harbor under a strengthening northeasterly breeze. But just 44 would finish, 5 would sink, and 6 experienced sailors would drown. Sayonara, an 80-foot maxi boat owned by Oracle Chairman Larry Ellison, with Rupert Murdoch's son Lachlan onboard and America's Cup skipper Chris Dickson at the helm, finished first. But after the tragedy, there would be no awards ceremony. "This is not what racing is supposed to be," said a stunned and mournful Ellison, who promptly left.

There was one Cassandra even at the start. He was Roger "Clouds" Badham, a private meteorologist hired by some 20 boats to give them a competitive edge. Badham was already predict-



SURVIVOR:
Sayonara,
owned by Oracle
Chairman Larry
Ellison, finished
in first place

ing one of the worst storms on record next. *Fatal Storm* by Rob Mundle, an Australian journalist and former TV weatherman, was written in just 16 weeks following the disaster and published in 1999. *Knockdown*, by California adventure writer Martin Dugard, was originally launched as an e-book, then also rushed into print in 1999. *The Proving Ground*, by G. Bruce Knecht, a reporter for *The Wall Street Journal*, is just hitting stores. Focusing on the already much-covered Ellison, it's the smoothest read of the three, but it's mostly the same tale, recounted two years later.

Three books tell what happened next. *Fatal Storm* by Rob Mundle, an Australian journalist and former TV weatherman, was written in just 16 weeks following the disaster and published in 1999. *Knockdown*, by California adventure writer Martin Dugard, was originally launched as an e-book, then also rushed into print in 1999. *The Proving Ground*, by G. Bruce Knecht, a reporter for *The Wall Street Journal*, is just hitting stores. Focusing on the already much-covered Ellison, it's the smoothest read of the three, but it's mostly the same tale, recounted two years later.

Knecht's failure to produce fresh details or insights may just be because nautical disaster stories are intrinsically narratives of courage, heroism, and fatal

screwups. Like the storms they often feature, such books get their energy from the supercharged immediacy of the event. Introspective, reflective types who might produce a more analytical account are usually aboard boats like these.

Mundle simply wants to tell the story, and he does it well. An Aussie who has sailed the Sydney Hobart and covered it for two decades, he has the tactics, strategy, and weather down pat. He nails all of the leading skipper and many family members in the aftermath, and—a real plus—includes 33 pages of dramatic black-and-white photos of demasted, capsized, and sinking craft amid 60- to 80-foot waves. (The McGraw-Hill Company, his publisher, is also the owner of *BusinessWeek*.)

Dugard concentrates on the Australian boat that won under handicap rules, the smallish 35-foot *Midnight Rambler*. He blames the Australian Bureau of Meteorology for underplaying the storm and the race organizer for failing to call the event off. Dugard's melodramatic style doesn't help, however, and he leaves you wondering how much anyone could have done once the boats were trapped in the storm.

All three writers grapple with the fatal attraction that led so many to believe they could beat the storm. In other words, it was their ultracompetitiveness. When boats were upended by monstrous waves and survivors learned a competitor was blown out, they often saw it as a better chance to win. Ellison, whose big boat was one of the ones that didn't come back the next year. But the maxi competitors, and most of the smaller ones, did.

BY BOB DOWD

Assistant Managing Editor
who is a coastal sailor.

ONE RACE, 115 YACHTS, FIVE SINKINGS, SIX DROWNED SAILORS

JAMES C. COOPER & KATHLEEN MADIGAN

DON'T LET INFLATION WORRYWARTS POIL YOUR SECOND HALF

Industrial weakness and soft labor markets will limit price pressures

U.S. ECONOMY No wonder economics is called the dismal science. Just when prospects for growth in the second half look better, a few economists are now wringing their hands over the wing danger of inflation—and efforts by the Federal Reserve to preempt it. Already, bond yields are up sharply since mid-March, as investors demand a higher premium for possible inflation losses.

But let's not get too far ahead of the game. There's much to argue against inflation taking root anytime soon. First, although lower interest rates and tax cuts could buoy consumer demand, business-sector cutbacks in capital spending and labor costs will prevent a strong recovery that could boost companies' pricing power. Second, although productivity growth is tanking, revised first-quarter data show, it should pick up as the economy recovers, and the current upward pressure on unit labor costs will ease.

SERVICES GAIN FROM LABOR'S REVISIONS

JOB GROWTH, DEC. TO APR. *		
	ORIGINAL	REVISED
ALL PAYROLLS	149	105
PRIVATE SERVICES	179	247
MANUFACTURING	-373	-346
CONSTRUCTION	123	60
GOVERNMENT	203	132

*THOUSANDS OF WORKERS
Data: Labor Dept., BusinessWeek

Third, inflation lags the business cycle. By autumn, the economy will have grown only 1% for an entire year, far below its sustainable rate. That means there will be plenty of slack in the industrial sector to prevent prices from spiraling up. Inflation may well be peaking right now.

All this is why Fed Chairman Alan Greenspan remains sanguine about the inflation outlook. It's also why further cuts in interest rates, if only as recovery insurance, are still a good bet. Nevertheless, some Fed policymakers appear to be getting antsy about all the stimulus already in the pipeline, and the next cut may well come only a quarter point. That's especially likely since the May employment report, with its assortment of revisions to old data, shows that job growth so far this year is not as weak as the past data had suggested (table).

MAKE NO MISTAKE, though, the economy and the labor markets are still very soft. Nonfarm payrolls declined in April and May, and manufacturing job losses are getting progressively larger. Moreover, the dip in the unemployment rate, to 4.4% from 4.5% in April, is just a fluke, not a change in the trend. Joblessness is expected to rise in coming months, consistent with the increase in unemployment-insurance claims.

The lower May jobless rate, which is based on the Labor Dept.'s survey of households, occurred in conjunction with declines in both employment and the labor force. That means many workers who lost their jobs simply left the labor force instead of looking for more work, in which case they would have been counted as unemployed. The biggest drop in the labor force was among teenagers, many of whom were clearly part-time workers, where the jobless rate fell sharply. Joblessness among full-time workers was unchanged.

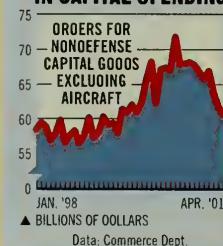
Labor's more closely watched survey of businesses showed a small 19,000 dip in May payrolls, but it was the revisions to previous data that changed the tone of the labor situation. April payrolls dropped by 182,000 instead of the 223,000 first reported, and the original March decline of 53,000 was revised to show a gain of 59,000. The revisions were particularly striking in private services. Originally, job growth there from December to April was said to have been 179,000. Now, it is 247,000, and the sector added 57,000 workers in May.

THE REAL TROUBLE SPOT in the economy remains manufacturing, which shed 124,000 workers last month. That drop, plus a shrinkage in the workweek, suggests that factory production in May posted a sizable drop, led by output cuts in business equipment, especially computers and related high-tech products.

Indeed, new orders for capital equipment excluding commercial aircraft posted a third consecutive large decline in April, the largest three-month drop since the last recession (chart). Orders for tech gear alone plunged 10.3% in April. Producers of tech equipment are wrestling with a mountain of excess inventories as shipments have fallen off sharply. The news was equally bad from the latest purchasing managers' survey. The May composite index of output, orders, employment, inventories, and delivery speeds fell to 42.1%, from 43.2% in April, indicating that the manufacturing sector is still in a recession.

The service sector, however, is holding its own. And because the labor markets remain relatively tight, hourly and weekly earnings continue to grow at a

MORE WEAKNESS TO COME IN CAPITAL SPENDING



Business Outlook

healthy clip. Hourly pay, up 4.3% from the year before, and weekly earnings, up 4%, are both rising faster than inflation and are providing solid support for consumer spending and confidence. Indeed, May auto sales looked surprisingly strong, at an annual rate of 16.7 million, up from 16.5 million in April. The resilience of consumers argues for a stronger second-half economy.

WHAT HARRIES the inflation worrywarts, though, is that the job markets may not have loosened up enough by the second half to reduce the upward pressure on labor costs. That concern was on the mind of Fed Governor Laurence H. Meyer when he spoke in front of the New York Association for Business Economics on June 6. Echoing a concern he voiced a week earlier in Scotland, Meyer said: "We have to be concerned that as we ease to mitigate the risks of a persistent slowdown or recession, we do not at the same time create conditions that would lead to higher inflation as the expansion gathers momentum."

Meyer's warning suggests that upcoming Fed policy meetings may be more spirited than normal, especially since, in a June 4 speech, Greenspan said: "Inflation is not a significant problem at this moment." And the Fed's favorite measure of inflation, the personal consumption expenditure deflator, which is calculated differently than the consumer price index, bears that out. Even though the core CPI, which excludes food and

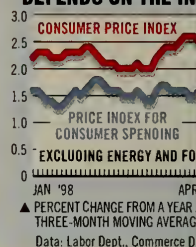
energy, has been increasing lately, the PCE deflator grew at a low 1.7% over the 12 months ended in April at the same rate as a year earlier (chart).

But the fear is that future productivity may not pick up fast enough to offset rising pay growth in the labor market where the unemployment rate peaked just over 5%. Bear in mind, though, that productivity is very cyclical. Businesses are reluctant to cut jobs as demand first weakens, so productivity—output per hour worked—tends to fall in a slowdown.

That's what occurred in the first quarter. Output growth slowed, work hours rose, and productivity fell at a 1.2% annual rate. And since compensation kept rising, unit labor costs soared by 6.3%, the biggest jump in a decade. It wasn't until April that businesses began large-scale layoffs. But output may be falling just as fast as jobs are, so productivity is likely to be weak again this quarter.

Come the second half, though, productivity should have a strong cyclical bounce as output picks up. That may mean the rise in compensation will not be inflationary. Bigger pay gains—plus the stimulus of lower interest rates and tax cuts—will fuel the recovery.

CORE INFLATION? DEPENDS ON THE IN



FRANCE

CAN A TAX CUT OFFSET THE EXPORT DRAG?

The global slowdown is getting a firmer foothold in France, causing a rise in unemployment and a drop in confidence.

In the first quarter, France's real gross domestic product grew 0.5% from the fourth quarter, when growth was a faster 0.8%. Although consumer buying was vigorous, rising 1.2%, businesses cut their inventories sharply, trimming 0.8 percentage points from real GDP growth.

The first-quarter slowdown suggests that France will grow by less than 2.5% for all of 2000, although the government of Prime Minister Lionel Jospin is still forecasting real GDP growth of 2.7% to 3.1%. The government is also sticking

with its plans to cut taxes by 38 billion francs (\$5 billion) in 2002, on top of a cut of 57 billion francs this year.

That stimulus will boost domestic demand, but it will not shore up export growth, which has been hurt by the U.S. slowdown and weaker growth in other parts of the euro zone, where France is the second-largest economy. Exports fell 0.6% in the first quarter, and early data suggest another decline in this

quarter. The purchasing managers' index fell to 48.1% in May from 49.4% in April, led by a steep drop in the export index.

Weaker foreign demand is also making factory executives more

pessimistic. Business confidence for manufacturers fell in May to the lowest level since June, 1997 (chart). And businesses are cutting payrolls. Although France's jobless rate was steady at 8.7% in April, the number of unemployed rose by 5,000. Weaker job markets are, in turn, making French consumers more wary. Consumer confidence fell in May to an eight-month low.

The European Central Bank's surprise interest-rate cut on May 10 will clearly help France's situation, but internal fiscal stimulus will have to do the bulk of the job. That's why the government is sticking with its plan to cut taxes. While that may widen the budget deficit, the cuts should kick in before the next nationwide elections are called within the coming 11 months.

BUSINESS CONFIDENCE TAKES A STEEP DROP



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KNOW HE
NEEDS AN
ALOHA SHIRT.



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GM PICKS UP SPEED

With truck sales accelerating, has the carmaker stopped its slide?

When it came time for Long Island bond trader Tom Fumai to get a new sport-utility vehicle last October, he had every intention of buying another Ford Expedition. But after comparing its performance, size, and styling with those of the new GMC Yukon XL introduced last year, Fumai, 39, didn't hesitate to ditch his loyalty to Ford. Says Fumai: "The Expedition is too small, and I like the styling on the GMC."

Score that as one big and surprising turnaround for GM. For most of the 1990s, Ford Motor Co. dominated the market for big pickups and SUVs, while GM, busy blowing cash to revamp its aging car line, remained a perennial also-ran. But thanks to improved styling, the freshest products on the market, and aggressive pricing, the No. 1 auto maker has already grabbed the lead in full-size SUVs and pickups. Now, it's out to beat a suddenly vulnerable Ford in Detroit's largest market: midsize SUVs, long ruled by Ford's popular Explorer.

More than bragging rights are at stake. Pickups and SUVs are Detroit's cash cow. While they account for 40% of total sales, they have been racking up 90% of profits. What's more, gaining the edge in trucks might halt GM's long market-share slide

and may even prevent what had seemed a foregone conclusion: that Ford would replace it as the world's biggest auto maker. "We will hold or gain market share this year," says William J. Lovejoy, GM's group vice-president for vehicle sales, service, and marketing in North America. "These are the products we can do it with."

Of course, the tricky part for GM will be to maintain profitability as the market toughens. Many of GM's new truck models are coming to market just as the souring economy, slowing SUV sales, soaring gas prices, and an increasingly crowded field are all taking a toll on once-rich truck profits.

So far, Wall Street seems happy just to get good news from GM. Thanks to its popular new Chevy Tahoe, it is surging

in full-size SUVs, where profit is \$10,000 to \$15,000 per vehicle. That helped send the stock up 16% this year to about 58. Ford is up just 4% to around 24. Many analysts are raising their earnings estimates despite the slowing economy and GM's weak car business. According to First Call, analysts think GM can earn \$2.1 billion for 2001.



SILVERADO

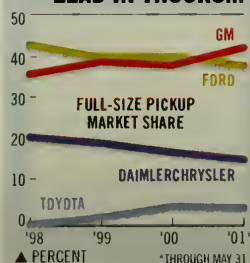


TAHOE

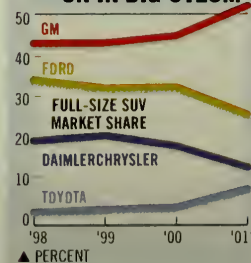


TRAILBLAZER

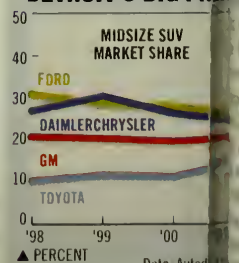
GM HAS TAKEN THE LEAD IN TRUCKS...



...AND IS POURING IT ON IN BIG UTES...



...NOW, IT WANTS DETROIT'S BIG PRIZE



Data: Autodata



om a projected \$1.7 billion in March. 'ord was the low-risk auto stock," says Stephen Girsky, an analyst at Morgan Stanley Dean Witter. "Now that GM is moving forward, that's not so clear."

How has CEO Rick Wagoner managed to turn things around? Basically, by improving everything. GM's Chevy Silverado pickup and its big SUVs—the Chevy Tahoe and Suburban, GMC Yukon, and Cadillac Escalade—all have more power than the old ones, plus better fuel economy. They're also more comfortable, with cushier seats and a softer ride than the competitors. Plus, GM's two-year-old trucks look more modern than the designs of Ford's five-year-old SUVs. Condes Ford Market Analyst George Pissis: "We're not the newest kid on the block anymore."

But that doesn't tell the whole story. Aside from GM, only Ford, DaimlerChrysler, and Toyota have vehicles in the large-SUV segment. And while Toyota Motor Corp.'s new Sequoia full-size SUV is coming on strong, its sales volumes are only a modest 100,000 a year, vs. more than 400,000 a year sold by GM. Ford won't have a new Expedition until early 2002, and Chrysler won't launch its new Dodge Durango full-size SUV until 2003. That window has boosted GM's sales.

Through May, its stake in the full-size SUV market jumped to 51.5%, while Ford's and Daimler's fell to 26% and 14%, respectively. And for the first time since 1994, GM has grabbed the lead in big-pickup sales from ex-segment leader Ford. Now, GM has 41.5% of the big-pickup market, vs. Ford's 38.4% stake.

But the hardest part of GM's Detroit Triple Crown is now unfolding. It aims to take the lead in the biggest and most competitive part of the truck segment: midsize SUVs. So far, GM has spent \$1.5 billion redesigning its midsize offerings—the Chevrolet Trailblazer, GMC Envoy, and Oldsmobile Bravada—which were launched three months ago. Taking a page from its success in full-size SUVs, GM's engineers came up with an all-new six-cylinder motor that delivers more power and better mileage than its predecessor. And, taking direct aim at the market leader, the Ford Explorer, GM engineers made their midsize engine more powerful than the Explorer's.

Surprisingly, GM, which has long been known for bland design, is also gaining points for style. Its new midsize SUVs

have stronger outlines, and their interiors, which had been smaller, are now the same size as the Explorer's. "GM's new SUVs come across as leading-edge and contemporary," says Christopher Cedergren, an analyst at Nextrend Inc. in Thousand Oaks, Calif. "The Explorer looks dated."

For now, GM is gaining on its Detroit rivals even without adding share.

Its piece of the midsize market has held roughly steady at 20% since 1998, while Ford has slipped 5 percentage points, to 26, and Chrysler has dropped 2.5 percentage points, to 25%.

FOREIGN RIVALS. Of course, it would be surprising if GM didn't gain at their expense. Chrysler continues to lose sales. High prices have caused its midsize Grand Cherokee, launched two years ago, to flop. And the lower-grade Cherokee is being phased out in favor of the compact Jeep Liberty, which is

new this year. As for Ford, its Explorer has gone from crisis to crisis. With the brand name already under a cloud because of rollover woes associated with Bridgestone/Firestone tires, the new Explorer has been recalled twice since its January launch. That has hurt sales: They're down 21% since the start of the year, vs. sales of the old model for the same period last year. Says Saul Rubin, an analyst at UBS Warburg: "With the Explorer reeling, there could be a swing to GM."

GM is counting on that. It has added 70,000 units of plant capacity to the 380,000 units for its old SUV models. If GM hits those targets, its midsize sales will match last year's record Explorer sales of 445,000. That would move GM close to the top spot in midsize SUVs this year. If sales continue to rise, it could take the lead in 2002.

Still, GM hardly has the field to itself. The biggest move in the segment may come from foreign rivals such as Toyota and Honda Motor Co. Largely on the strength of the new Highlander it launched early this year, Toyota's share in midsize SUVs has jumped from 10% in 1998 to 15% this year. And Honda has a midsize sport ute coming next year that is expected to be a big draw.

Elsewhere, too, competition is heating up. Overall, there are 56 SUVs on the

FLOORING IT

Building on its success in big trucks and sport utilities, GM is targeting midsize SUVs such as the Ford Explorer

market, vs. 45 last year. And they're all chasing a shrinking market. SUV sales grew just 9% this year and last, vs. sizzling growth rates of at least 15% from 1997 to 1999. "It's more of a crap shoot that we'll gain share," says Rick Spina, assistant vehicle line executive for GM's new midsize sport utes.

It's also more of a crap shoot that profitability can hold up. Auto makers

have been forced to raise the average rebate for midsize SUVs, to \$2,500 per vehicle, up from \$2,000 as late as November. Such moves have shaved the average truck profit by 10%, to about \$5,000 per vehicle. And it's likely to fall further. In early June, GM and Ford both slapped additional discounts on fullsize SUVs and pickups.

That's why GM's rise to King of the

Truckmakers may end up a less than filling victory. Sure, as Warburg's Ru says, trucks and SUVs "will still be most profitable for some time to come. But considering the cost of buyer incentives and rising competition, the payoff for owning that segment may be a less than it's cracked up to be.

By David Welch, with Kathleen Kerwin, in Detroit

COMMENTARY

By Joann Muller

FORD: JACQUES NASSER CAN'T DO IT ALL

With the Firestone tire fiasco and other woes on Jacques A. Nasser's desk, the last thing the Ford Motor Co. CEO needed were doubts about his authority. Yet that's what he faced last week as rumors swirled that the board might revamp management and pull Ford's European chief back to Detroit for a key operating role. And although no one suggested Nasser might soon be out of a job, Nasser made a point of telling a Bloomberg reporter that Ford's directors, led by Chairman William C. Ford Jr., were "extremely supportive" of him. Still, that hardly means things are hunky-dory on the executive floor. It has become obvious lately that the aggressive and often controversial CEO has gotten himself into deep trouble, and he is going to need a hand or two to help pull Ford out of the muck.

SHAKEUP. Even before the Bridge-stone/Firestone Inc. tire mess, Nasser had stretched himself too thin. Since taking over as CEO in January, 1999, he has pushed Ford in a host of ambitious new directions, piling on one initiative after another. He urged employees to get closer to customers. He overhauled management pay and performance practices. He hired a slew of outsiders to shake up Ford's culture. He adopted General Electric Co.'s approach to improving quality. He expanded Ford's luxury-car portfolio through acquisitions. He bought repair shops and auto junkyards. He even set up John F. Welch's transformation of GE as a model for his company, and for himself as CEO.

In short, Nasser wanted Ford to

be not only the world's top carmaker, but also among the top companies, period. But now he is learning the downside of aiming so high. The problem is, while Nasser has been leading Ford headlong into the future, he hasn't devoted enough time to the basics of running a \$170 billion auto company. How else can



you explain the embarrassing quality gaffes that have marred the launches of some of Ford's highest-profile vehicles, including the 2002 Explorer? Or the morale problems that have scarred the organization, and prompted class actions from disgruntled employees? "I think Ford management is really stretched," says one source close to Ford's senior management. "There are just too many initiatives going on. Now, they're paying the price for taking their eye off the ball."

No one is more overextended than Nasser himself. He has 16 executives reporting directly to him. General Motors Corp.'s CEO has nine. And

Ford has not had a head of worldwide automotive operations since Nasser held the job under his predecessor, Alexander J. Trotman, back in 1998. The hard-charging Aussie has also kept the auto job for himself; he



has also never named a chief operating officer. But given Ford's troubles, the smart money is betting he'll turn to Nick Scheele, chairman of Ford of Europe, for help with the auto

operations. Scheele is credited with turning around Jaguar in the 1990s and is now leading a turnaround of Ford's entire European operations.

Bringing in Scheele would also go a long way to fixing what many observers insist is Nasser's Bill Ford problem. Ford insiders say the chairman is miffed that Nasser has cut off his flow of information from senior execs. Both Nasser and Bill Ford have denied reports of a rift. But Ford, 44, has been known to flex his muscles in the past when corner-office guys messed up. And while insiders say Bill Ford prefers to remain a nonexecutive chairman, he could easily hand the keys to someone else. If Nasser wants to retain the support of Ford and the board, he had better focus on making Ford a top-flight carmaker once again. But no one says he has to do it all alone.

Muller covers the auto industry from Detroit.

**OVEREXTENDED
CEO Nasser
insists he has Bill
Ford's support.
Scheele may come
home to help**



ad campaign. Problem is, Energizer will relaunch its core battery later this summer with its own \$100 million campaign.

Fortunately for Gillette, Kilts knows a thing or two about fixing up companies. In his former job as CEO of Nabisco, he slashed costs and increased advertising. And he encouraged innovation. As a result, he reversed Nabisco's falling market share before selling the company

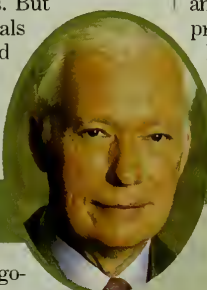
STRUCTURINGS

HAZOR BURN T GILLETTE

its cautious turnaround
may not sway investors

With its sweeping views of New York, the 106-story-high Windows on the World restaurant inspires ambitions. But when Gillette Co.'s CEO, James M. Kilts, unveiled his turnaround plan there on June 6, the was to bring investors down to h. Since 1998, Kilts's predecessors repeatedly promised that the King blades would soon return to the 15% 10% earnings growth it delivered ng much of the '90s. But s ridiculed those goals sure recipe for "bad sions," promising he ld set far more listic targets." ounds like a good . But n un- tain omy,

CEO
KILTS



53-year-old Kilts is go- to have to do a lot more that to rev up Gillette and nvestors again. Kilts, who ed on in February, faces umental challenges. Along Coca-Cola Co. and Procter amble Co., Gillette benefited itly as globalization opened new markets in the 1990s. that tide has turned against tte as the global economy soured.

In the past several years, Gillette has been losing market share in products accounting for some two-thirds of its sales, including batteries, toothbrushes and disposable razors. Profit margins are plummeting, the stock price is in the dumps, and employee morale is at a low point. At Duracell alone, says Kilts, "turnover has been staggering."

To sharpen Gillette's performance, Kilts is going to need to repair the battery business. Since paying \$7 billion for Duracell, Gillette has captured the premium end of the market with its Ultra battery. But by neglecting the mass market, it has been taking a beating from Energizer and Rayovac, which have cut Duracell's overall share to 46%, from nearly 50% in 1997. In the first quarter, operating profits plunged 49% on a 14% drop in sales.

RECHARGED. Regaining share and profits will require more innovative marketing and more competitive pricing. "They have priced themselves right out of their market," says Gary Stibel, a partner at New England Consulting Group. Kilts has already brought in a new president. Later this month, he'll relaunch Copper & Black under the name Coppertop, backed by a \$100 million

to Philip Morris last year.

Now, Kilts must prove he can work similar magic at Gillette. To boost profitability, he must take a sharp knife to "a sloppy, undisciplined organization that has let the bureaucracy get out of control," says Harvard Business School professor Rosabeth Moss Kanter. He vows to slash capital spending by \$250 million a year, weed out the marginal products that take up vital shelf space, lay off 3,300 employees, and cut inventories to 90 days, from 120. But more cuts may be needed. Many analysts, for example, think he ought to exit Braun's marginal household-appliance business altogether.

Kilts will have to do all that and more if he's to win back the investment community, which has been burned by a run of bad news in recent years. The onetime highflier has seen its stock sink from a high of \$63 in early 1999 to \$28 after three years of flat sales, declining earnings, and eroding market share for most products. Even so, with a multiple of 27 times this year's expected earnings, "this is not a cheap stock," says Robert E. Torray, president of Torray Corp., a major investor.

Conceding that this "will be a transition year," Kilts warns that it may take until yearend, or even next year, to see results. Still, with some of the world's strongest brands under his belt, if Kilts can deliver like he did at Nabisco, Gillette should be able to grow at a consistent 10% annual clip, figures Patrick Schumann, an analyst at Edward Jones. That may not sound like much. But it may be the best Gillette shareholders can hope for.

By William S. Symonds in
New York

GILLETTE WHERE THE PROBLEMS LIE

DURACELL

The world's leading battery maker is losing share to Energizer and Rayovac. Operating profits fell 49% in the first quarter alone.

SHAVING

Although it's still Gillette's core business, bloated inventories helped depress first-quarter profits by 13%.

BRAUN

Despite its strength in electric razors, Braun's household-appliance unit is a costly distraction.

COMMENTARY

By Howard Gleckman

THE TAX BILL: A WEB OF FALSE PROMISES...

If all goes as planned, on June 7, President Bush will sign into law a sweeping \$1.35 trillion tax cut. But hold the balloons. This may be the worst piece of tax legislation in years. Liberals hate it because it drains so much money from federal coffers. Conservatives grumble because it does little to boost long-term investment. But most troubling are its gimmicks and false promises. "It is," says Robert V. DiClemente, chief economist at Salomon Smith Barney, "a triumph of cynicism."

In a nutshell, here's what the legislation promises: a \$45 billion stimulus in 2001, followed by another \$350 billion in tax cuts through 2005, mostly aimed at folks with taxable income below \$50,000. From 2006 to 2010, the law promises \$800 billion more in relief, mostly for upper-bracket taxpayers, thanks to rate cuts, generous new rules for contributing to retirement plans, and the repeal of the estate tax.

What's so terrible? To start, while the law provides an immediate kick to the economy, it does little to boost growth in the long run. Economic consultant ISI Group figures it will boost growth in late 2001 and early '02 by about one percentage point. But the stimulus quickly fades. Long-term growth requires new investment. This tax cut excels only at raising short-term consumption. The slow phase-ins of top-bracket rate cuts and other savings incentives trash its supply-side benefits. By the second half of 2002, Salomon's DiClemente figures, the cuts will generate little more than one- or two-tenths of a percentage point of extra growth. "I don't see any discernible long-term impact," he says.

Just as troubling, the law turns the tax code into a muddle. Just try tax-planning based on this bill (page 156). Families get new education tax breaks in 2002 but begin to lose them in 2006. Most couples will have to wait years to get any marriage-penalty relief. The estate tax isn't repealed until 2010. Then, in 2011, the

entire bill is undone. Why? Because no one wanted to admit that it cost another \$250 billion in 2001. Yale University law professor J. Graetz: "This is not responsible lawmaking."

There are other gimmicks, too. The law not only cuts official tax rates but also repeals two hidden taxes that reduce the value of personal exemptions and itemized deductions for upper-

come families. For many, ending those backdoor levies would nearly double the benefits of the rate cuts.

But they are not fully repealed until 2010. Worse, of those same taxpayers will get clobbered by the alternative minimum tax (AMT)—a separate set of rules for

whose deductions and credits limit their tax bill too sharply. Because the law's new rate cuts and exemptions will be up to 35 million taxpayers will be tossed into the AMT by 2010. So the new law provides modest relief only until 2005. Then, just as the tax cuts start to kick in, the protections disappear. The millions of people who expect tax cuts are in for a shock.

HIDDEN COSTS. The problem won't be fixed—at a cost of \$300 billion. And if all the plays were done, the package would cost in excess of \$1 billion over the decade. Bottom line: The law is either going to bust the budget or do a lot less than advertised.

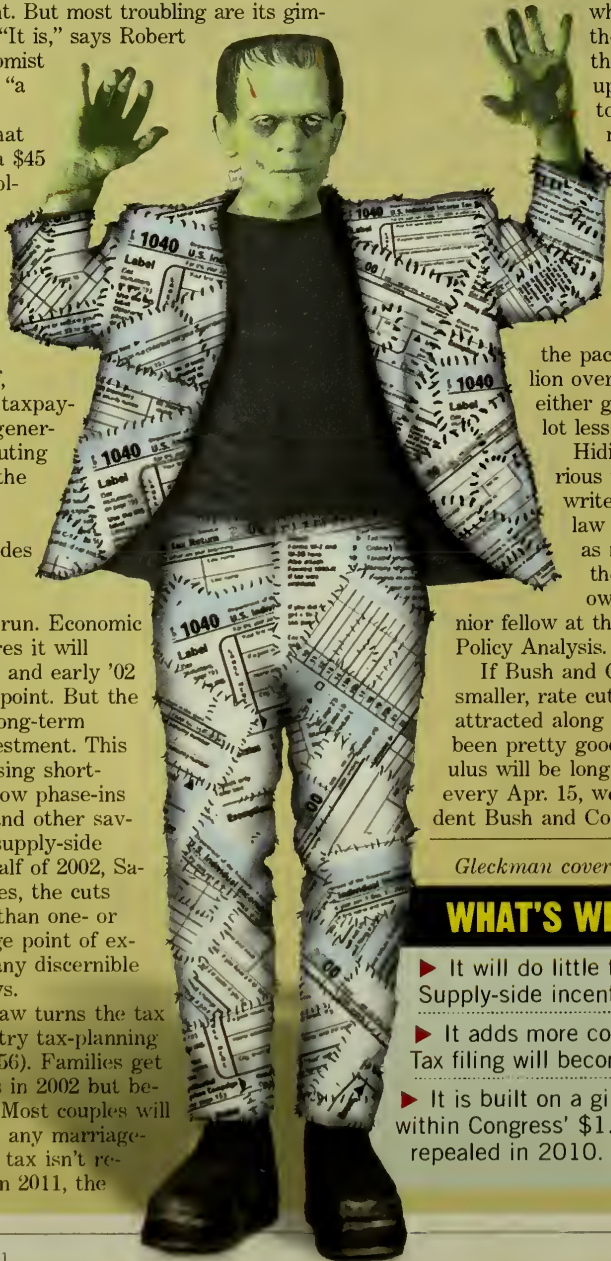
Hiding that fact, rather than making a serious tax policy, became the goal of the writers. Congress set a price for the law of \$1.35 trillion and then squandered as many goodies as possible. "The law turns itself into a straitjacket of its own making," says Bruce Bartlett, a senior fellow at the conservative National Center for Policy Analysis. "That led to this idiotic result."

If Bush and Congress had embraced quicker, smaller, rate cuts and ditched all the flotsam, the package would have been pretty good. As it stands, the ephemeral stimulus will be long forgotten in just a few years. Every Apr. 15, we'll be reminded of the mess that President Bush and Congress just created.

Gleckman covers tax policy from Washington

WHAT'S WRONG WITH THE TAX BILL

- ▶ It will do little to boost growth in the long run. Supply-side incentives take years to kick in.
- ▶ It adds more complexity to a tangled tax code. Tax filing will become even more of a headache.
- ▶ It is built on a gimmick. To make cuts fit within Congress' \$1.35 trillion limit, the entire bill is repealed in 2010.



COMMENTARY

By Michael J. Mandel

...NO. IT WILL PROVIDE A REAL ECONOMIC JOLT

politics goes, the Bush tax cut is about as sloppy as it gets. It's an inconsistent, capricious hodgepodge. Changes in the tax code wink on and off like out-of-control Christmas lights. To take only the worst of many egregious examples, the tax law repeals the estate tax in 2010 and restores it in 2011.

Despite its gimcrack nature, the new tax law has a lot to recommend it. It funnels a hefty chunk of fiscal stimulus to a slowing economy. In the early years, it delays the benefits of the tax cuts to working-class and middle-income taxpayers. And it delays the big cuts for the rich until later in the decade, when it will be clearer whether the current budget surpluses are real. If they aren't, everyone in Washington assumes that those cuts will never actually take place. Ultimately, that could be more fiscally responsible than enacting big cuts now. Although the Administration resisted including a trigger that would force cuts if the surplus doesn't materialize, the economy itself will act as the trigger.

Look at the short-run fiscal stimulus first. In previous downturns, it has taken many years for tax cuts to get approved—and then more time to get money into the hands of consumers. By the time taxpayers receive any relief, the recessions generally have been over. This time is different. Congress acted fast for it is lightning speed, and thanks to the \$45 billion in rebate checks by September, that's a much bigger slug of spending power sooner than anyone expected. That could be a crucial factor in keeping the economy out of a deep recession in the second half. Depending on how much of it is spent and how much saved, the rebate could really boost growth in gross domestic product. If passed, the Bush tax bill could overturn the conventional wisdom against tax cuts as a recession-fighting tool. The reason is technological: To determine who should get rebate checks, the Internal Revenue Service is

using fast computers to compile the list of people who paid taxes in 2000. That would have taken much more time in the past. The technology to accurately and quickly spew out rebates, for instance, wasn't available when Ronald Reagan signed his tax-cut legislation in August, 1981. Instead, his tax cuts were put in place by changing the withholding schedules—a much slower process. That's why the economy received almost no stimulus until the middle of 1982, when the recession was almost over.

A second key feature of the Bush bill: Benefits for working- and middle-class taxpayers come sooner and more certainly than benefits for the rich. A new 10% tax bracket—which applies to the first \$12,000 of taxable income for married couples, for example—is retroactive to Jan. 1. But high-income taxpayers must wait for the rate reductions of the top four tax brackets, which will be phased in over the next five years. Similarly, the hefty tax cuts for the wealthiest Americans, such as lowering the estate tax rate and raising the estate tax exemption, don't take full effect until later in the decade.

SANE STRATEGY. Given the uncertainty of today's big surpluses, that's the best approach. The people who need the money get tax relief right away.

Meanwhile, the final fate of the high-end tax cuts is pushed off into the future. If fast growth and big federal budget surpluses continue for the rest of the decade, it's likely that the cuts for well-to-do taxpayers will take effect. But if growth slows, or if deficits return, then pressure to reduce or eliminate the tax breaks will grow. Since no one knows how fast the economy will grow in the next decade, this approach delays the hardest decisions to a time when there will be better information—a reasonable strategy.

True, the possibility of such changes makes long-term tax planning difficult.

But anyone who expects stability from the U.S. tax code is looking at the wrong country. In the past 20 years, marginal rates have been lowered twice and then raised twice, depreciation allowances have bounced up and down, and savings incentives have been added and subtracted. Even the 1986 tax bill, held up as a paragon of reform, revoked the investment tax credit retroactively. History suggests that major tax bills come every five years or so.

While repairing the AMT might require quicker action, that's just about right for fixing most other problems with this bill.

This is by no means a perfect tax bill. It's the result of a messy political process, reflecting a bitterly divided Congress and hastily crafted compromises. But, oddly enough, it gets the job done.

Mandel covers the New Economy from New York.



IT'S RIGHT WITH THE TAX CUT

It gives a quick burst of fiscal stimulus to a slowing economy.

It delays the benefits of tax cuts in the early years to working-class and middle-income taxpayers.

It is fiscally responsible, delaying big tax cuts for the rich until later in the decade when it will be clearer whether budget surpluses will last.

ENERGY

CALIFORNIA'S GIANT GAME OF CHICKEN

Animosity between pols and producers could stall new plants

It's hard to imagine, but the California electricity crisis has gotten even uglier of late. "They are the biggest snakes on the planet Earth," Governor Gray Davis recently said of the state's power suppliers, adding not long after: "If they do not cooperate I'll have no choice but to sign a windfall-profits tax or seize plants." California Attorney General Bill Lockyer adds that he may file a price-gouging suit against the state's power producers in the next few weeks. More ammunition came on June 5, when one producer, AES Corp., revealed that the Justice Dept. is investigating allegations that the company conspired to gouge customers. On June 6, the Democratic-controlled U.S. Senate said it's considering new legislation to impose price caps on California's wholesale-electricity rates.

Power companies are hardly taking the threats lying down. Increasingly, they seem intent on making sure state officials know there's a limit to how much they can be pushed around. On June 1, Mirant Corp., a major producer recently spun off from Atlanta's Southern Co., confirmed that it will not begin construction of a newly permitted plant near San Francisco until the investment climate in the state improves. Duke Energy Corp., another major California producer, says it might adopt a similar position with its proposed plant on Morro Bay in the central part of the state. "Our members are asking themselves: 'Is it safe to build in California?'" says Gary Ackerman, executive director of the Western Power Trading Forum.

NO MYSTERY. As the California electricity crisis enters its second summer, the situation seems to be disintegrating into a giant game of chicken. Politicians are trying to pressure producers to cut prices and lower the roughly \$5.5 billion tab they claim they're owed from previous power sales. The generators want to avoid being hit with wholesale price caps or dragged into court for price-gouging, a prospect that seems more likely every day. The result is continued uncertainty—and the distinct possibility that many new power plants might not get built. "We're looking

HARSH WORDS

"They are the biggest snakes on the planet Earth.... If they do not cooperate, I'll have no choice but to sign a windfall-profits tax or seize plants."

—GRAY DAVIS

California Governor



BIG QUESTION

"Our members... are asking themselves: 'Is it safe to build in California?'"

—GARY ACKERMAN

Executive Director of the Western Power Trading Forum



at another summer of blackouts, high prices, and a tremendous amount of cord," says Lawrence Makovich, an electricity analyst at Cambridge Energy Search Associates.

It's no mystery why Governor Davis and other California officials are under the pressure. The state is already on the hook for more than \$7 billion in power purchases, and the prospect of another summer price surge could make the governor's plan to sell bonds to pay off the state's power debts. Since the show that most Californians believe producers are to blame, bashing those businesses just as major rate hikes begin to kick in might also score points with voters. "It plays well at home," says a legislative aide in Sacramento.

The risk, though, is that a poisoned atmosphere could dissuade power producers to build the state just when California needs new plants the most. The state has approved new plants that will produce more than 11,000 megawatts of power, a 22% increase over current production capacity. That should

be enough, according to a recent report from Deutsche Banc Alex. Brown, to balance California's supply and demand by 2003. But earlier this year, the California Energy Commission projected that 5,000 megawatts of new plants would be online by July. Now, the agency says only half that will be ready by then.

Noticeably absent from the list of new plant developers are Dynegy and Reliant Energy, two companies that

GOING UP:

Duke builds a new generator

have increasingly come under fire for alleged price-gouging. Both are active developers in other markets. "Still,

ty is probably the biggest concern we have about making any new capital investment," says Dynegy Inc. President and Chief Operating Officer Stephen Bergstrom. "The rules keep changing even as we speak."

Therein lies the rub. Even if power companies are overcharging or otherwise gaming the market to their benefit, as many have alleged, the state politicians and regulators have all choice but to work with them to solve the state's power problems. Producers, too, clearly have little long-term interest in exiting what remains one of the country's largest power markets. This game of chicken neither side can win.

By Christopher Palmeri in Los Angeles, with Peter Coy in New York and Wendy Zellner and Stephanie Anderson Forest in Dallas

GETTING THE FARM ON ETHANOL

corn producers hope Bush will back the fuel additive



Facing a global glut of corn that has brought prices to a 10-year low of less than \$2 a bushel, Illinois farmer B. Dart barely breaks even today. He thinks President Bush may save—and thousands of other corn growers in the Midwest. Any day now, Bush is expected to decide on a complicated pollution question that would force California to use ethanol in its gasoline. The backs expanded use of the corn-based fuel additive, Bush could double the 1.9 billion-gallon domestic market for ethanol by 2005.

That prospect has Dart hopping. A "yes" O.K. means Dart would "invest \$1,000—maybe more"—in a \$50 million ethanol plant to be run by a cooperative. But it wouldn't be a boon just for folks like Dart. It would also mean a tremendous win for agribusiness backers of the additive, particularly Archer Daniels Midland Co. in Decatur, Ill., which provides about half the nation's ethanol.

IN BURN. Problem is, it's far from what Bush will give the Corn Belt what it wants. He's caught smack in the middle of a heated battle between the oil industry and the state of California on one side, and environmentalists

NOT SO GOLDEN: Bumper harvests have sunk corn prices to \$2 a bushel

and ethanol supporters on the other.

The reason? Ethanol adds oxygen to gasoline, helping it to burn more cleanly. Since Congress amended the Clean Air Act in 1990, California and other high-pollution states have been required to add additives to their gasoline to reduce smog. California has long used the oil-based additive MTBE (methyl tertiary butyl ether) rather than ethanol, but MTBE is being phased out because it is a carcinogen. So California will have to switch to ethanol by 2003.

That would be a boon for the ethanol industry, which has been growing by 10% or so in recent years. But gearing up

for the \$28 billion gasoline market in California and other states, ethanol makers have massive plant expansion under way. They figure demand will rise from 1.6 billion gallons last year to 4 billion by 2005. Agribusiness giant ADM is expanding one of its five plants to produce a further 50 million gallons a year just to meet current demand. "We're waiting for the orders," says Larry H. Cunningham, senior vice-president at ADM, which now produces 850 million gallons a year.

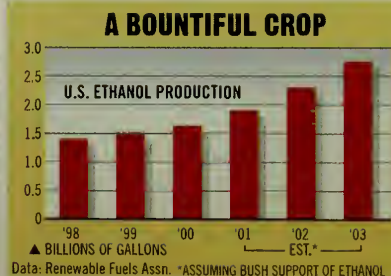
Although it is the largest ethanol supplier, ADM is hardly alone in coveting the California market. All told, there are 56 ethanol plants in the nation, with expansions going on at 34 of them. Most are in the Midwest. Eight other plants are under construction and 40 more are on the drawing board, with construction scheduled to begin either this year or next, according to the Renewable Fuels Assn., the ethanol industry's Washington lobbying arm.

PRICIER GAS. But both California and the oil industry are dead set against making the switch to ethanol. The state argues that the additive is unnecessary and will simply make its already pricey gasoline even more expensive. Governor Gray Davis petitioned the federal government for an exemption in 1999 from the federal regulations, and that petition is now on Bush's desk awaiting a decision. "We've proved you can make gasoline as clean as it needs to be without an oxygenate," says Richard W. Varenchik, a spokesman for the California Air Resources Board. Oil producers—for whom the use of ethanol would complicate production and cut into profits—heartily agree. They say they can meet California's stringent air-quality standards by reformulating gasoline to burn cleaner without oxygen additives.

Bush has close ties to both sides of the argument. Sure he's an oil man, but he can hardly risk angering ADM, a big campaign contributor, or the farm belt. With mid-term congressional elections approaching in 2002, Republicans are wary of annoying corn belt interests in such key states as Missouri, Illinois, and Iowa. "I would be surprised if he does something to undermine [the support he has in the Midwest]," says Elisa

Lynch, campaign director for San Francisco's Bluewater Network, head of a coalition of 93 grassroots environmental groups. One way or the other, Bush stands to make some people a lot of money—and some others unhappy.

By Julie Forster in Chicago, with Lorraine Woellert in Washington



COMMENTARY

By Jay Greene

CASE VS. GATES: PLAYING FOR THE WEB JACKPOT

Six years ago, Microsoft and America Online cut a deal that will go down as one of the savviest ever. Microsoft Chairman William H. Gates III agreed to put the Internet service provider's icon on the desktop of its Windows software. The easy access for consumers helped generate nearly 30 million subscribers for AOL's online community and propelled it to the top of the Web heap. In turn, AOL then-CEO Stephen M. Case agreed to make Microsoft's Internet Explorer its default Web browser, ultimately helping to give it millions of browser users.

Now, in contentious negotiations over bundling AOL into Windows XP, the next generation software due out on Oct. 25, Microsoft and AOL are playing a game with even more at stake. Each company is currently jockeying to be the dominant player in the next generation of the Net, when consumers are expected to shell out billions on such services as access to new music and online game playing. The outcome of the talks could play a big role in whether Microsoft can successfully maneuver to displace AOL as the king of the consumer Web—or whether AOL can contain Microsoft. “The ultimate goal for both companies is to own the living room in the U.S. and eventually take that to the world,” says Rob Lancaster, an Internet analyst at Yankee Group Research Inc.

WHO NEEDS IT? Thing is, whatever hand Microsoft plays, AOL has better cards. Sure, computer makers will sell nearly 160 million Windows-loaded PCs next year. That's a big reason why AOL is again negotiating to get its icon front-and-center in the new Windows. But AOL can do that without Microsoft. In recent years, it has cut deals with the biggest computer makers. It costs AOL money, but many now put its icon right on the PC desktop.

What's more, Microsoft needs AOL

more than AOL needs it. A year ago, Microsoft laid out a sweeping new Net strategy dubbed .Net. It promises to let unrelated Web sites talk to one another—and to other programs on a consumer's PC. For example, .Net would allow a user to purchase

stock, transfer funds for the purchase, and update his personal-finance software with just one click.

But to succeed with .Net, Microsoft needs consumers to give it a try. That's why AOL is so crucial. While its MSN Internet Access service has doubled to 5 million—making it the No.2 service behind

AOL—AOL's 30 million consumers are a far juicier prize. If Microsoft can convince AOL to let use of its own instant messenger service talk with AOL's as part of the Windows XP deal, for example, it could help the software giant get AOL's customers to try .Net.

Of course, AOL risks losing customers in the process.

That's why it's holding onto its doozy of a trump card—the threat to pursue further legal action against the software giant for antitrust. Microsoft is clearly loading Windows

with all sorts of new features aimed directly at AOL. For example, on June 4, it announced a service built right into its operating system that offers text messaging, voice conversations, video conferencing and document sharing. AOL's take? That Gates & Co. are still using Microsoft's Windows monopoly to leverage into applications markets.

Microsoft is pushing AOL to agree not to sue over such new disputes. AOL could also still bring a private antitrust suit over earlier claims involving Netscape. But AOL is balking. “It makes no common sense, no business sense, no legal sense, and has no precedent for us to give them a get-out-of-jail-free card,” says AOL Executive Vice-President Kenneth Lerer. AOL clearly recognizes Microsoft is aiming for the very heart of its business. If it isn't careful, a wily Microsoft may play its way to the biggest jackpot yet.

With Amy Borrus, who covers America Online in Washington



A High-Stakes Game

WEB BROWSERS

AOL wants prime placement within Windows XP. Otherwise, it threatens to switch from Internet Explorer to its own Netscape Navigator. But that could alienate customers.

INSTANT MESSAGING

Microsoft failed to get AOL to tie its popular IM to MSN's rival Messenger Service. Microsoft wants that tie to be a condition of the deal.

STREAMING MEDIA

Microsoft wants AOL to offer its Windows media player. That would open a huge new market—but threatens AOL's partner on that turf.

ANTITRUST LOBBYING

AOL execs continue to lobby Congress about Microsoft's alleged anti-competitive conduct. Gates & Co. want AOL to forgo any legal action.



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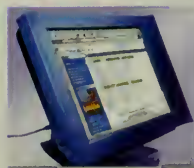
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EDITED BY MONICA ROMAN

GE TAKES A SOFTER LINE WITH THE EC

SIGNALING A NEW NEGOTIATING stance, General Electric is offering a major concession to European Commission anti-trust regulators in an effort to save its \$45 billion deal to buy Honeywell. GE has offered to sell Honeywell's regional jet engines unit, according to a European source. Still, the Europeans want more. They may press for a GE sell-off of Honeywell's entire avionics division, the crown jewel in its portfolio. The Europeans also worry that GE's aircraft financing arm, GE Capital Aviation Services, will give the newly-merged company too much of a competitive advantage. GE Chairman Jack Welch will travel to Brussels to negotiate with chief European regulator Mario Monti on June 8. Welch dismissed news of the

Honeywell engines unit sale, which was first reported in *The Wall Street Journal*, as "speculation."

NAPSTER GETS SOME BIG BUDDIES

THE ONLINE MUSIC-SHARING service Napster, nearly crippled by its copyright lawsuit, signed a deal with MusicNet—a joint venture between RealNetworks, AOL Time Warner, Bertelsmann, and EMI—to be its exclusive supplier of major-label content. MusicNet had promised to license music to Napster when the venture was announced in April, but contracts weren't signed until June 5. "This is a big step forward for consumers," says Rob Glaser, MusicNet's interim CEO. Presuming they can get over one big catch, that is: The record companies will not allow Napster to sell their content until the upstart "tracks the identity of files" and is operating in a "legal non-infringing manner." So far, the music giants say that's not the case.

A BLOCKBUSTER OF A LEGAL BILL

VIDEO RENTAL GIANT BLOCKBUSTER is offering to settle 23 class actions from customers who allege the Dallas-based retailer charged excessive late-return fees. If approved by a federal court, the settlement would compensate some 40 million customers who paid late fees over the past eight years. They would be given coupons for rentals or nonfood purchases at Blockbuster, a unit of Viacom. But the real winners in the settlement are the lawyers who sued the company on behalf of customers. As part of the deal, Blockbuster must pay—in cash, not coupons—\$9.25 million in court costs and attorneys' fees.

HEADLINER: CHARLES HOFFMAN

SOMEHOW, HE FINDS THE BRIGHT SIDE

GIVE CHARLES HOFFMAN credit: He's not afraid of a sinking ship. On June 5, struggling high-speed Internet access provider Covad Communications announced that Hoffman will become chief executive on June 25. Hoffman succeeds interim CEO Frank Marshall, who will stay on as Covad's vice-chairman.

Hoffman, now CEO at Canada's Rogers Wireless Communications, will have his hands full at Covad. On June 1, the once high-flying Santa Clara (Calif.) company received notice that it could be delisted from Nasdaq because it does not

meet asset requirements. Covad lost \$1.35 billion of \$158.7 million in revenue last year, and its shares are trading at \$1.40. That may sound bleak, but Hoffman "doesn't see it that way," says Covad Chairman Charles McMinn. After dealing with the Nasdaq mess, he'll have to raise the \$400 million to \$700 million in financing that Covad needs to keep the lights on before its cash flow turns positive, hopefully, in the second quarter of 2002. With capital markets tight, finding that kind of money won't be easy.

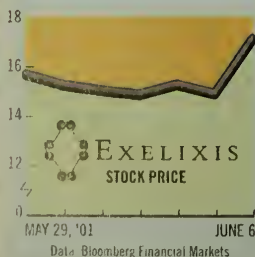


Jim Kerster

CLOSING BELL

ZEBRAFISH FLASH

Exelixis shares soared 14.2%, to \$17.16, on June 6 after it announced the completion of a functional genome map of the zebrafish. It marks the first time that scientists have figured out all the genes in a vertebrate that control the structure and function of the heart and other organs. Humans and fish share about 95% of the same genes, so the discovery could have a big impact on drug development.



AMAZON ADDS AN ONLINE PC STORE

AMAZON.COM, WHICH BOASTS the "Earth's biggest selection" of goods ranging from books to housewares, is getting even bigger. On June 5, the online retailer announced it would add a personal computer store as well as a business bookstore by the end of the year. The company estimates that selling business books alone could bring in \$100 million to \$150 million in new revenue within two years. Amazon will need every penny of it to live up to its promise of operating profitability, excluding certain debt-related costs, in 2002.

A SMOKE BOMB FOR BIG TOBACCO

IT'S BEEN A BAD WEEK FOR the tobacco industry. On June 6, a Los Angeles state court

jury awarded an injured smoker more than \$3 billion in compensatory and punitive damages from Philip Morris Cos. That came just two days after a Brooklyn jury found Philip Morris and four cigarette makers to fork over nearly \$30 million to Erika Blue Cross and Blue Shield for increasing insurance costs in that state. The two courtroom losses put an end to a long winning streak for Big Tobacco. Philip Morris had to appeal both the Los Angeles and Brooklyn verdicts.

ET CETERA...

- Newport News Shipbuilding backed General Dynamics' takeover bid over Northrop Grumman's rival offer.
- Lucent will offer early retirement packages to more than 10,000 managers.
- Cadbury plans to buy Gailina and other brands from Pernod for about \$500 million.



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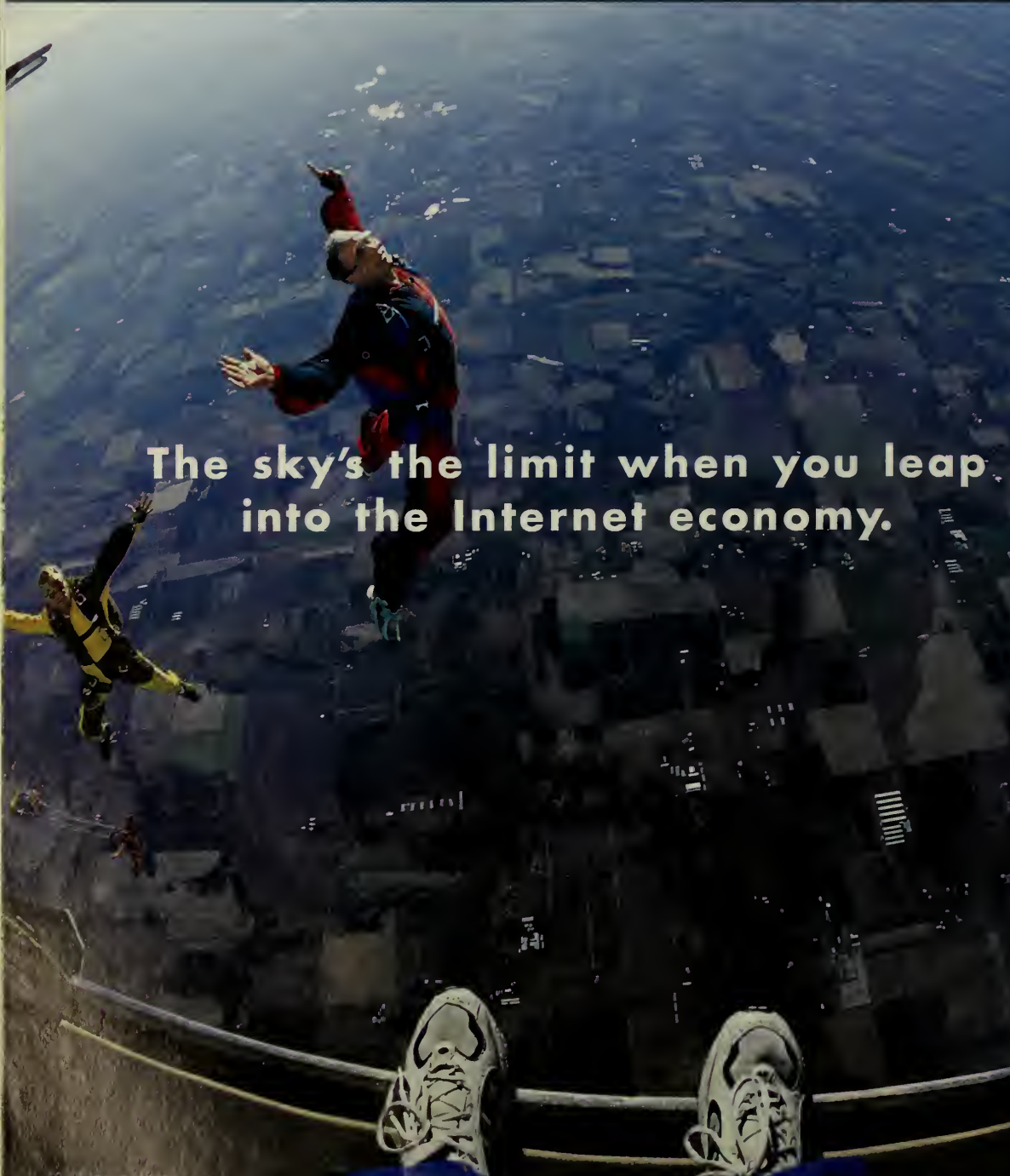
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EDITED BY LEE WALCZAK

McCain's Game: Keep Playing to the Centrist Crowd

Senator John McCain talks a lot about his hero, Teddy Roosevelt. But these days, the Arizona Republican seems to be stealing pages from the game book of another ex-president—Bill Clinton. Case in point: triangulation, the Clinton-honed art of playing one ideological faction off against another. Now that the Democrats' Senate takeover has cost McCain his perch as Commerce Committee chairman, he is trying to maintain his visibility by forging alliances midway between the GOP Right and the Democratic Left. And his populist agenda keeps getting longer.

The Arizona Republican is even appropriating some of Clinton's signature issues, such as a national service plan for young people that expands on the AmeriCorps program. And though Sen. F. Hollings (D-S.C.) will succeed him as Commerce Committee chair, the pair will team up on a bill requiring airlines to improve service—or face possible lawsuits. McCain is also cosponsoring a bill with Senator Chuck Schumer (N.Y.) that would get generic versions of patented drugs on the market sooner. All those issues are on top of McCain's already lengthy list, which includes: Internet privacy rules, the "American Jobs" Bill of Rights (page 75), and a war "corporate welfare" and Pentagon pork.

WINNING POLLS. The goal for McCain is to broaden his coalition of independents, Reagan Democrats, and moderate Republicans. If the strategy succeeds, "John will become the linchpin of a stable center-Left coalition," says one associate. To that end, McCain is also consulting with Clinton's New Democrat advisers, such as Bruce Reed, president of the Democratic Leadership Council, and Will Marshall, head of the Progressive Policy Institute, a centrist think tank. "He's seizing a market niche," says HUD Institute fellow Marshall Wittmann, a McCain adviser.

According to pollsters, McCain's base for such a fusion agenda is already impressive. In a May 28-31 Zogby Poll, Re-

publicans viewed McCain favorably, 58% to 22%, while independents backed him by an astounding 61% to 16%. Democrats, too, liked McCain, 49% to 21%, even though a friend notes that "he has about a 5% rating" from liberal groups. "There is a centrist movement in the nation, and McCain is chairman of the board," says pollster John Zogby.

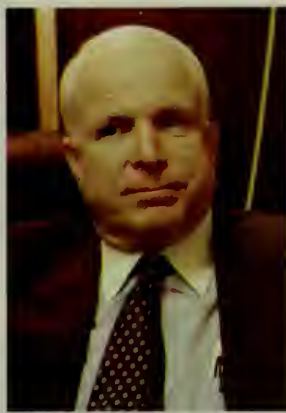
How about a try for CEO of America Inc.? McCain says unequivocally that he has no plans to bolt the GOP or launch an independent White House bid—rumors that took wing after aides let their imaginations roam too freely over lunch. But there's little doubt McCain, 64, is keeping his options open in case Bush does a belly flop in 2004.

For now, McCain is busy being wooed by both sides of the aisle. Incoming Senate Majority Leader Tom Daschle (D-S.D.) flew to the Arizonan's ranch on June 2. And President Bush—whose aides have kept McCain at arm's length—hosted him at a June 5 dinner. "There's going to be a better mutual understanding," says a McCain adviser. "McCain is still fighting to be the 'reformer with results' that Bush promised [he would be]."

Despite dinner with George, McCain faces continuing skepticism from the GOP. Most party elders think he's an opportunist who is lurching left to further his ambitions. Indeed, McCain is walking a political tightrope despite all the massive publicity he's receiving. "He needs to be careful not to burn bridges," says Senator Chuck Hagel (R-Neb.), a McCain pal.

McCain's immediate goal is a legislative blitz that puts to rest his rep as a big talker who rarely delivers. As to his long-range ambitions, even his advisers are in the dark. "There is no grand plan," insists one. Ultimately, McCain's fortunes could depend on how much he can accomplish in coming months—and how many toes he steps on in the process.

By Richard S. Dunham, with Lorraine Woellert



WILD CARD: *Courted by all*

CAPITAL WRAPUP

FEEL: BUSH TO THE RESCUE?

Who was that man standing beside the president of the United Steelworkers at a rainy June 6 rally on Capitol Hill? Why it was none other than Commerce Secretary Donald L. Evans. Along with Treasury's Paul H. O'Neill and others, Evans has concluded that global steel glut has reached crisis proportions for U.S. steelmakers. So Administration task force reached a surprising conclusion: Despite Bush's free-trade evangelism, it's time for a pragmatic shot of relief.

Whether the Bushies can actually negotiate voluntary restraints remains unclear, since presumed offenders like Brazil and Russia are peddling cut-rate steel in part to keep shaky economies afloat. But the politics of the decision is clear: Bush narrowly carried steel state West Virginia, lost steel bastion Pennsylvania, and must shore up his strength in Midwestern industrial states. He also hopes to swap steel protection for Democratic support of fast-track.

As an initial step, the Administration is asking the International Trade Commission to investigate high levels

of steel imports and suggest remedies. Bush can either accept the ITC's recommendations or go with curbs on a handful of products.

But slapping quotas on imports and organizing international price-setting cartels is not exactly in the GOP's free-trade lexicon. And a crackdown on steel imports poses a particular problem for Bush as he sets off on a round of foreign-policy and trade consultations in Europe. Also, overly restrictive curbs could raise the prices of U.S. cars, appliances, and machinery.

By Paul Magnusson



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JAPAN

A PEEK AT PLAN KOIZUMI

Nothing is on the table yet, but what's emerging looks radical

Junichiro Koizumi, Japan's new Prime Minister, is on a roll. He recently made front-page news by showing up at the annual sumo tournament to present the Emperor's Cup to the new champ. The fans roared—as audiences do almost everywhere Koizumi appears—and tossed their seat mats into the air. Later, the TV networks had a field day when he presented flowers to opera singer Plácido Domingo after catching a June 3 performance of *Samson et Dalila*.

Koizumi mania is sweeping the nation. Polls gauge the colorful Premier's approval rating at 80%. But skeptics are wondering how long the euphoria can last. For the other Koizumi, the economic taskmaster, hasn't yet begun to tighten the thumbscrews on Japan's economy. "It will definitely hurt—that goes part and parcel along with structural reform," says Hiroshi Okuda, head of the Japan Federation of Employers' Associations, or Nikkeiren, and chairman of Toyota Motor Corp.

Despite Koizumi's reformist rhetoric, few concrete proposals for change had emerged from his government until recent days. Now he has begun putting some meat on his skeletal reform plan. His Council on Economic & Fiscal Policy, a think tank of bureaucrats, economists, and academics headed by Economy & Fiscal Policy Minister Heizo Takenaka, is leaking portions of what could be called Plan Koizumi.

Some of the Prime Minister's proposals are downright radical. Those who thought Koizumi's talk about

"structural reform without sanctuaries" was empty rhetoric a few weeks ago are pleasantly surprised, says Fujitsu Research Institute Chairman Toshihiko Fukui. "We can only see the fragments of the plan, but I have high expectations."

Such hopes may prove misplaced: No reformist legislation is on the table yet. But these are proposals no one has dared to float before. The overall goal of the plan is to rein in Japan's fiscal deficit, in part by capping bond issuance at \$250 billion in 2002. That means drilling deep into the hidden recesses of Japan's budget: road construction and other public works, social welfare spending, and all sorts of grants and subsidies to local governments. The plan will spread the pain to big prefectures like Tokyo, Kanagawa, and Osaka, which have yawning fiscal gaps of their own.

SLAYING THE BEAST. The council would practically reinvent local government to recover Japan's fiscal soundness. One proposal, for instance, would merge Japan's 3,200 hamlets, villages, and towns into 300 metro areas. The goal is to reduce the duplication of local services such as garbage collection, public education, and policing. Further, the think-tank council wants to reallocate \$36 billion in gasoline and other auto-related taxes, which have been steered to road construction in rural areas, and use the money for urban projects and central government social services.

There's also a plan to slay the beast that the politically connected construction industry has turned into. Takenaka and Koizumi would axe about \$40 billion worth of regional public works spending;

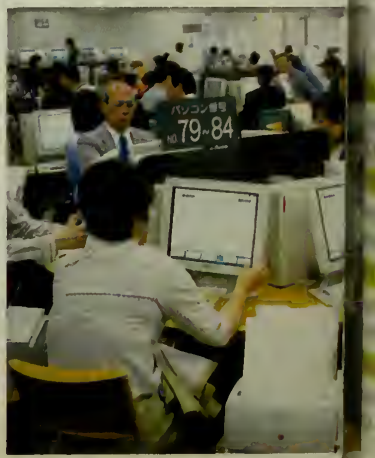
THE BIG SHIFT

The plan would favor safety nets such as job placement centers and starve white elephants like the Aqua-Line span



there would be no more white elephants like the Aqua-Line Bridge over Tokyo Bay, which drivers shun because of high tolls. And Tokyo would abolish the practice of covering 50% of the principal and interest payments on local government bonds—ones that fund projects such as concert halls in rural areas. It would keep construction crews busy and the Liberal Democratic Party chapters well supplied with campaign gifts.

Even more surprising is Koizumi's privatization plan. He has long argued that Japan's \$2 trillion-plus postal savings system, now managed by the government, should be put into private hands. But on top of that, the council is considering a plan to sell off Narita International Airport.





Meda international airports
state-owned corporations
such as Japan Highway Corp.,
which funds road construction.
Many of the 70-odd state-
owned corporations like the
National Forest Service and
Japan Development Bank that are not
d off would be forced to raise funds
the capital markets instead of casually
rowing money from the postal sav-
s system.

In a clear attempt at intellectual as-
all as economic reform, ex-academic
Tenaka is even going after his own
1. He would privatize several nation-
universities and then make it harder
the professors, now treated like civ-

ON A ROLL Koizumi has high popularity rat- ings and Japan Inc.'s blessings

il servants, to get tenure.
"The system gives tenure to
guys in their 20s, who don't
have to compete or publish,"
says Hirotaka Takeuchi, dean
of Hitotsubashi University's
Graduate School of Interna-
tional Corporate Strategy. "This is going
to shake a lot of people."

Even Japan's seniors may be in for
some pain. Japan's rapidly aging society
has sent government health spending
on the 70-plus crowd into the strato-
sphere. The health-care budget for the
group is approaching \$85 billion and ab-
sorbs about 30% of all medical expendi-
tures. With Japan's heavily subsidized
health system in danger of collapsing,

Koizumi wants to cap spending per pa-
tient or hike the payroll deductions that
help pay for it. Those ideas were once
politically unimaginable.

One key area for which Koizumi has
no concrete plan is bank reform. Clear-
ing out the banks' crushing load of bad
debt and restructuring their operations
is the responsibility of Financial Ser-
vices Agency head Hakuo Yanagisawa.
He wants better disclosure and a
greater willingness to cut off dead-beat
borrowers. "Speeding up the disposal
of bad loans over a two- to three-year
period will trigger a rise in unemploy-
ment," notes Toyota's Okuda, so the
challenge is to soften that blow. The is-
sue will likely be put off until after
July's elections for the Upper House.

BUSINESS BACKING. The question now is
whether Koizumi can turn his ideas into
law. He has surprising support from the
business Establishment, given the pain
involved. A massive contraction in pub-
lic spending, combined with bank re-
form, would hammer the private sec-
tor, too. For Japan Inc. to cleanse itself,
says Akio Mikuni, president of Japanese
credit-rating agency Mikuni & Co., the
nation "will probably have to reduce
overall industrial and service industry
capacity by 25%." Koizumi promises to
ease the pain by expanding jobless ben-
efits and redirecting spending from pub-
lic works to job retraining.

To make any of this happen, he first
has to guide his party to victory in July,
then get his full Cabinet, including his
many foes in the ruling LDP, behind the
plan. If he can't, he may call a snap
election for the Lower House. His hope:
that the public gives him as warm an
endorsement at the polls as they have
when he poses with sumo wrestlers and
opera stars.

*By Brian Bremner and
Chester Dawson in Tokyo*

KOIZUMI'S REFORM BLUEPRINT

AUSTERITY From 2002 on, cap bond issuances at \$247
billion a year. Targets: Public-works and social welfare spend-
ing, plus special grants to prefectures.

PORK ROAST Slash funding by 20% or so to seven state-
linked companies that focus on highway construction and
business lending.

CITY PERKS Remaining public-works spending will be tilted
toward such major urban centers as Tokyo and Osaka instead
of rural Japan.

PRIVATIZATION Put in private hands big public universities,
an array of municipal services, and of course, the sprawling
postal savings system.

Data: BusinessWeek



COMMENTARY

By Stephen Baker

WHY EUROPE KEEPS GOBBLING UP U.S. COMPANIES

At the height of the Internet gold rush, Europeans routinely waved to each other across the tables at Il Fornaio, the dealmakers' restaurant of choice in Palo Alto, Calif. These were Europeans from Alcatel, Siemens, and Nokia, and they were on the prowl for Internet smarts. Last year alone, European companies poured a quarter of a trillion dollars into the U.S. This represented 80% of all direct foreign investment, according to the U.S. Commerce Dept.

Now, of course, the Internet has lost its luster. The Europeans' two takeover currencies, their shares and the euro, are both down. Corporate profits are falling. And Alcatel's \$23 billion buyout of Lucent Technologies Inc. just collapsed under a heap of transatlantic acrimony. Could all of this signal that Europe's buying binge in America is on the wane?

Don't count on it. The U.S. continues to cast a strong enough spell over Europeans to keep drawing mergers-and-acquisitions teams across the ocean. It was the appeal of the powerful U.S. market that pushed Alcatel to shop for Lucent, even as the French company was facing a painful \$2.7 billion write-down. Days later, on May 31, French media conglomerate Vivendi Universal spent \$2.2 billion on U.S. publisher Houghton Mifflin Co. And Germany's Bayer is jousting with Bristol-Myers Squibb Co. for DuPont's pharmaceutical arm, a deal that could be worth \$8 billion. "It's easier to raise return on equity by buying in America than by restructuring back home," says Eric Chaney, an analyst with Morgan Stanley Dean Witter & Co. in London.

So investments will keep flowing west. Net flow in direct investment out of Eu-

rope reached \$43 billion in the first quarter of this year, says Morgan Stanley Dean Witter. That shows no letup from the last two years. Moreover, while many economists expected the investment flow to reverse in



2001 as European growth outstripped America's, U.S. companies are sitting on their wallets. Why? First, with earnings falling, they have less money burning holes in their pockets. And Europe's slowing growth, expected to reach barely 2% this year, dampens the appeal.

Europe's fragmented economy tilts investment away from the Old World and toward America

But the Europeans keep shopping, and they benefit from post-crash bargains. In recent months, the focus of their fascination has shifted from technology to customers. Alcatel, for example, spent \$17 billion for North American tech companies during the Net boom. The

company needed routers and optical switches to make a go of it as a Web supplier. But in its failed bid for Lucent, the French company was far less interested in Lucent's tech jewels at Bell Laboratories than in the company's stable of megaclients, including Verizon Communications and AT&T. Even though the Alcatel deal failed, other European suitors, such as Germany's Siemens or Britain's Marconi PLC, could soon be angling for Lucent.

COHESIVE MARKET. Europeans find in America precisely what they're struggling to build back home: a cohesive, united market.

With Houghton Mifflin, Vivendi's Jean-Marie Messier can sell textbooks throughout the world's largest sales territory. Vodafone Group and Deutsche Telekom, which spent a combined \$114 billion in their deals for AirTouch Communications Inc. and VoiceStream in the U.S., can peddle cellular service from coast to coast. By contrast, American operators like Bell South Corp. and SBC Communications Inc. attacked Europe country by country—a fabulously expensive proposition. Now, both companies are selling their European holdings and retrenching in the Americas.

Here's the paradox: Europe's fragmented economy, still divided by languages and varying regulations and customs, hampers growth on the Continent and tilts investment away from the Old World. Yet this westward migration is transforming Europeans from Vivendi to Deutsche Telekom into global giants. Europe has plenty of other would-be giants. They'll keep busy growing in America, down cycle or no.

Baker covers European technology from Paris.



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EHLERDING SHUNS THE LIMELIGHT

GERMANY

IS THIS MAN A CORPORATE RAIDER?

Karl Ehlerding says he is not, but German business disagrees

Karl Ehlerding dislikes the corporate raider rap. The 58-year-old financier from Hamburg sees himself as a German Warren E. Buffett, a seeker of undervalued assets. In fact, shares in his main investment vehicle, WCM Holdings and Property, delivered a Buffett-worthy eighteenfold increase from 1995 until they began a 50% decline in late 1999.

Whatever you want to call Ehlerding, Germany Inc. just wishes he would go away. In January, WCM completed its \$1 billion takeover of packaging and machinery maker Klöckner-Werke. Now, WCM has declared its intention to make a bigger move, which could be worth as much as \$3.5 billion. Press speculation focuses on MG Technologies, the Frankfurt engineering and chemical company once known as Metallgesellschaft. Regardless of the target, in the board-

rooms of Germany Inc. nervousness about Ehlerding's next move is palpable. "It will come this year," promises Ehlerding.

Ehlerding represents the next wave in German corporate restructuring. Until recently, companies in the same industry attacked each other in hostile takeovers or merged peacefully, all in a quest for global dominance. But in a throwback to the 1980s, the aim now is to buy an undervalued company that can be quickly resold at a profit—usually in pieces. "We don't do turnarounds," says Ehlerding protégé Roland Flach, WCM's CEO.

That kind of deal is about to get a further push. From next Jan. 1, German companies will be able to sell their stakes in other, publicly listed companies without paying capital-gains tax. That should unleash a wave of deals as Germany's banks, insurers, and utilities unravel their holdings. Ehlerding can't wait. "Germany is a good place to do business," he enthuses.

Ehlerding, the son of a Bremen crab dealer, has shown a knack for dealmaking since he was a business student in the mid-1960s. While doing research, he stumbled on a nearly defunct local railroad in Hildesheim that held undervalued tracts of land. He scraped to-

EHLERDING'S RISE

1960s Still a college student in his twenties, Karl Ehlerding raises \$135,000 from friends and relatives to buy an ailing railroad line. Closes the railroad, sells real estate, and more than triples investment.

1991 Converts WCM, the shell of an 18th-century textile company, into a vehicle for investments.

1995 WCM moves from real estate to buying and selling undervalued companies such as grocery chain Spar Handels.

2001 WCM concludes hostile takeover of machine tool maker Klöckner-Werke. Announces aim to make another acquisition for up to \$3.5 billion within a year.

Data: WCM, BusinessWeek

gether \$135,000 from friends and family and bought control, stunning management. Ehlerding quickly shut down the line and resold the land, more than tripling his investment.

HUGE GAINS. In the past five years Ehlerding has bought and resold everything from a grocery chain Spar Handels, a stake in clothing retailer Wünsche, and a car parts maker Ymos. He has also bought some 60,000 apartments. Under German law, WCM can apply the losses at other companies it acquires against gains in its real estate portfolio. So WCM historically pays little or no tax on profit.

Ehlerding's methods lead to charges that he is cold-blooded. In 1999, WCM had to give ground in a bitter battle for control of a suburban streetcar line near Frankfurt. It turned out part of the line was home to a collection of antique locomotives. Big mistake: Vintage trains are sacred objects in Germany. In the end, WCM accepted a compromise that allowed the trains to keep operating.

Ehlerding is not infallible. In the Klöckner takeover, WCM spent almost a year negotiating an agreement with Klöckner managers to avoid a hostile takeover. As talks dragged on, Klöckner sold WCM shares and boosted its price. WCM shares slid from \$12, forcing Ehlerding to sweeten the cash and stock offer. The shares have since risen to \$16.30, but WCM may never see the next time around.

What's the new target? Analysts are betting it's MG Technologies, which owns profitable chemical assets but an anemic stock price. Ehlerding denies the speculation, though he won't reveal the target. Regardless, vows Flach, "If we start it, we'll see it through. I am one who knows Ehlerding has no doubts about that."

By Jack Ewing in Frankfurt

WCM PICKED UP KLOCKNER FOR A COOL \$1 BILLION THIS YEAR



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LATIN AMERICA

WHAT'S IN THAT PILL?

In Latin America, fake drugs are as lucrative as cocaine

In mid-May, investigators from Colombia's National Institute for the Supervision of Medications & Foods (Invima) discovered a thriving drug operation in Bosa, a poor neighborhood of Bogotá. Instead of cocaine or heroin, investigators found something else. Workers inside a trio of tiny dilapidated houses were cranking out more than 20,000 counterfeit tablets daily of flu drug Dristan, a generic aspirin known as Dolex, and Ponstan 500, a popular painkiller made by Pfizer Inc. "The drugs were produced in filthy conditions," says Invima General Director Dr. Miguel Rueda. Invima says the pills contained boric acid, cement, floor wax, talcum powder, and yellow paint with high lead levels, all used to replicate the genuine medications' appearance.

In Colombia and elsewhere in Latin America, counterfeiting of over-the-counter and prescription medicines is big business. So big, in fact, that major pharmaceutical makers in Europe and the U.S. are sounding the alarm about counterfeit drugs getting into consumer outlets throughout Latin America and even abroad. "The scourge of counterfeit medicines is spreading rapidly across the globe, and it would be a mistake to think any country is immune to it," says Jim Christian, head of corporate security for Basel-based drugmaker Novartis. The result is a serious loss of revenue

SCARY:
Confiscated knockoffs

for all global drugmakers. Worse, some consumers have gotten very



BIG BUSINESS:
Raiding a Bogota warehouse

pharmaceutical manufacturers' Association (IFPMA) in Geneva conservatively estimates that 2% of the \$327 billion worth of drugs sold each year are counterfeit, or about \$6.5 billion worth. In some representative of the world's biggest drug companies believe that \$19 billion worth

sick—and even died—because of the conditions these drugs are produced in or the unsafe ingredients used in their manufacture.

Hearings this month in Washington will shed some light on this fast-growing industry. Counterfeits range from copies that have the same efficacy as the original to those with few or no active ingredients to those made of harmful substances, such as the pills found in Bosa. The counterfeits also stand apart from prescription drugs made correctly, under safe conditions, by reputable drug manufacturers in India, Argentina, and elsewhere that choose not to honor traditional patents but don't mislabel their product, either.

THE U.S., TOO. Counterfeits, in contrast, are deliberately peddled as the real thing. Fakes can be produced for less than a penny, then sold to distributors at discounts of up to 80% off what legitimate manufacturers charge. The knockoffs are purchased by unsuspecting pharmacies, hospitals, and government health agencies, which pass them on to consumers. Some of the drugs even end up in the export market.

How bad is the problem worldwide? The International Federation of Phar-

counterfeits are sold annually. In some African and Latin American nations as much as 60% are counterfeit.

The globalization of the knockoff trade frightens investigators. "How can we expect to keep those products out of the U.S., Europe, and Japan?" asks Harvey E. Bale, director general of the IFPMA. The World Health Organization thinks 8% of the bulk drugs imported into the U.S. are counterfeit, unproven, or substandard. In late 1997, three different counterfeit drugs—two hormone treatments and one cancer medicine—were discovered for sale in eight U.S. states.

One way to stem this tide is better regulation in emerging markets. In the wake of several deaths triggered by counterfeit drugs administered to prostate-cancer patients, Brazil has enacted legislation that makes counterfeiting of drugs a crime punishable by 10 to 15 years in jail and a fine. That's a step in the right direction. But as long as the world's poor need cheap medications, the counterfeit drug industry will continue to flourish.

By Kerry Capell in London and Suzanne Timmons in Bogotá, Colombia bureau reports



A GLOBAL EPIDEMIC OF COUNTERFEIT MEDICINES

Identical Copies Less common than other counterfeits, these are made with the same ingredients, formulation, and packaging as the originals.

Look-alikes The packaging and appearance are high-quality, but there may be little or no active ingredient. Some look-alikes may even contain harmful substances such as boric acid, glass, or fungus.

Rejects Medications that have been rejected by the manufacturer for quality reasons are illegally obtained by counterfeiters from incinerators, repackaged, and sold on the black market.

Relabeled Bottles of authentic drugs that have expired are soaked in hot water, relabeled with a much later expiration date, and sold.

Data: BusinessWeek

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SURPRISE: BUSH AND EUROPE MAY FIND COMMON GROUND

When George W. Bush left his Crawford (Tex.) ranch for 1600 Pennsylvania Ave. in January, European critics thought he took too many of his swaggering cowboy mannerisms with him. In no time at all, Bush dumped the Kyoto global-warming accord and vowed to build a National Missile Defense system (NMD) that allies fretted could spark a new arms race. To top it off, on June 5 the President signaled his intention to negotiate new limits on imports of steel from the European Union, Asia, and South America. The predictable reaction abroad: It was a return to Lone Ranger diplomacy, Reagan-style.

But as Bush prepares for his first official trip to Europe on June 11, signs are growing that behind the scenes the two camps are inching closer to some sort of consensus. Credit visits to the U.S. by European officials and a flurry of diplomatic consultations as Administration officials fanned out across Europe recently. To the Europeans' surprise, the talks were "not just cosmetic" but substantive, says Karl-Heinz Kamp, head of international planning at Berlin's Konrad Adenauer Institute.

LESS TROUBLE. Take missile defense, a likely topic for the NATO summit in Brussels on June 13. While allies are skeptical about cost and feasibility, they privately concede that the U.S. is correct in its analysis of new threats. "Europeans cannot deny that there is a real strategic rationale for NMD. There is a ballistic-missile threat from the Middle East and North Africa for Europe," says a European defense-industry official. Indeed, NATO has launched its own theater missile defense program—separate from the U.S. initiative—with five consortiums of defense contractors vying to do feasibility studies.

Similarly, on environmental issues Bush may also be heading for less trouble in Europe than thought just a few weeks ago. True, he may run into public protests, since the envi-

ronment is a sensitive issue. But European officials are more alarmed at Bush's peremptory approach to the Kyoto Protocol than to his core contention that it is unenforceable and lets developing countries off easy. Bush's outright rejection of the treaty "looked like the U.S. does what it likes when it likes, and how it likes," complains William Hopkinson, an associate fellow at London's Royal Institute of International Affairs. Still, "Europeans know hardly anyone will be able to fulfill the Kyoto guidelines," concedes the Adenauer

Institute's Kamp. The trick now is coming up with a new approach that will be both politically and economically acceptable to all parties. That will take time. To disarm his critics, Administration sources say Bush may concede global warming is a problem and offer general ideas for new ways to address it.

Bush will probably face his most critical test when he meets Russian President Vladimir Putin on June 16 in Slovenia. Both sides have a stake in improving relations, which started off with a U.S. spy scandal reminiscent of the cold war. NATO's plans for expansion as far as the Baltics is still a sore point. But Moscow and Washington both want deep cuts in their nuclear arsenals. And they may avoid a confrontation over missile defense if Bush says he'll consider talks to amend—rather than junk—the Anti-Ballistic Missile Treaty. "I don't



BUSH: Diplomatic offensive

think there is any possibility of any deal" on NMD at the meeting, says Vyacheslav A. Nikonov, president of the Heritage Foundation, an independent Moscow think tank. The outcome, he says, would be a decision to appoint Russian and American experts to discuss NMD and defer decisions until the two sides improve relations in other areas. Such a promise would advance Bush's goal of keeping NMD alive—allow the President to enjoy his European trip after all.

By Stan Crock in Washington, with bureau reports

GLOBAL WRAPUP

INDIA'S NEPAL WORRIES

► The aftermath of the massacre of the Nepalese royal family on June 8 is worrying Nepal's ally and southern neighbor, India. Analysts fear a political vacuum in Nepal could be filled by Maoists, who form the main opposition party and enjoy 37% support. Nepal watchers say the Maoists may present themselves as the only stable factor in the troubled nation.

The Maoists want to depose the royal family and end links with India. Their ascension to power would leave Nepal

open to closer ties with China and Pakistan, both rivals of India. An added danger for India could be the strong Maoist insurgencies in the northern Indian states of Bihar and Uttar Pradesh. International affairs analyst Kanti Bajpai of New Delhi's Jawaharlal Nehru University says the Maoist groups could join forces and "create a very unstable northern Himalayan belt."

JOSPIN'S LATEST PROBLEM

► French Prime Minister Lionel Jospin suffered little short-term political damage after admitting on June 5 that he

covered up his Trotskyite past. But the affair still creates risks for his planned race next year against President Jacques Chirac. Jospin, a moderate socialist who previously insisted he was never a Trotskyite, was forced to reveal after journalists uncovered evidence he belonged to a Trotskyite cell as early as 1981. While conservative leaders denounced him for lying, public reaction was muted. Still, the disclosure could undermine Jospin's ability to attack Chirac, who has dodged questions about corruption scandals dogging his Rally for the Republic party.



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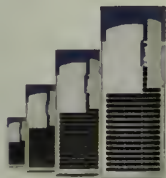
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BOB LUTZ: THE FIRST VIRTUAL CARMAKER?



The ex-Chrysler president has designed a super-luxury sports car—and wants suppliers to put it together

Robert A. Lutz is living large. The 69-year-old former Chrysler Corp. president still flies his Soviet-era fighter jet and speeds around Detroit in a Dodge Viper. His status as North America's preeminent car guy—earned in the early 1990s, when he helped reinvigorate Chrysler with cool, risky vehicles—is unchallenged. In fact, even though Lutz left the company after its merger with Daimler Benz in 1998, Chairman Jürgen E. Schrempp still consults him about how to fix the auto maker. Schrempp likes to call Lutz his

rabbi. Indeed, Lutz is one of the few people in the industry who tells it like it is: At the Detroit Auto Show in January, he said many of the sport-utility concept cars “resembled angry kitchen appliances.”

What's more, Lutz has enjoyed some success as a CEO in his own right. In the two years since he took over troubled battery maker Exide Technologies, he has settled its legal problems (the U.S. attorney's office accused Exide of deceptive sales practices), cleaned up its books, and acquired one of its rivals.

Now, Lutz is putting his good name and moxie to work for himself. He has started a company called Cunningham Motor Co. to build what would be the first super-exclusive sports car (it would go for about \$250,000) to come out of

America in 50 years. Actually, “but” might not be the right word, since Lutz only wants his company to design the car. He would like Cunningham's suppliers, whoever they end up being, to piece the vehicle together, with one handling the final assembly.

The idea is clever, and it certainly reduces the amount of money Cunningham needs to get started since there would be no plants to construct, no distribution centers to maintain, and hardly any expenses to rent. Even so, Lutz is spending about some \$80 million; the engine could cost \$20 million to develop. Raising that much will be tough. After all, automotive history is littered with romantic failed startup efforts, from Edsel Ford and John Z. DeLorean in the late 1940s to John Z. DeLorean in the 1990s. Lutz and his partner, Briggs S. Cunningham III, the son of racing legend Briggs S. Cunningham Jr., have each invested about \$5 million. So far, they've raised about \$2 million from others.

Few fault the car's design. A model of the Cunningham C7, a sleek coupe with a much bigger interior than European sports cars, went over well at the Detroit Auto Show. Lutz describes it as combining the lush leather appointments of a Bentley

INVESTORS NEEDED: Lutz wants a model of the Cunningham C7

the performance—powered by a 500-horsepower V12 engine like a Ferrari. He figures he can sell about 1,000 cars a year, even in an economic downturn. “There are enough wealthy people who have all the Mercedes-Benzes and Ferraris they'll ever own. If they don't have something new that their friends don't have, they'll buy it,” he says. **NO TAKERS.** Lutz has tried before to define American luxury, as he puts it, when he led the development of prestige concept cars that never made it to showrooms. Now, after 30 years working for the big carmakers, Lutz is operating on his own terms. The thought, is that he may need his old colleagues to get the C7 on the road. Industry analysts believe he'll have to work with another car company to cut development costs and share parts. “It's hard to talk about this, but it's very tough to do,” says David E. Cole, director of the Center for Automotive Research in Detroit. “Someone like Lutz has prestige, but he requires a partner, preferably



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C I T . c o m

ROBERT A. LUTZ

BORN

Feb. 12, 1932,
Zurich, Switzerland.

EDUCATION

B.S., Production Management, 1961 and M.B.A., 1962, Univ. of California, Berkeley.



CRITICAL DECISION

Before college, joined U.S. Marine Corps for the discipline. Rose to captain's rank as a fighter pilot.

POSITIONS

Chairman of battery maker Exide Technologies; co-founder of luxury-car

designer Cunningham Motor.

HONORARY TITLE

Detroit's ultimate "car guy."

AUTO JOBS

Worked at GM, BMW, Ford Motor, and Chrysler.

CAREER HIGHLIGHT

Reinvigorated Chrysler's product line to help steer it

away from bankruptcy in early 1990s.

AFTER HOURS

Flies his Czech-made L-39 jet fighter; drives one of 17 collectible cars.

FAMILY

Married to third wife, Denise; four grown daughters from his first marriage.

other auto maker."

That's the trouble. Lutz may be the best-connected executive in Detroit, but no one seems ready to risk hooking up with him. He talked to another former employer, General Motors Corp., about building new versions of a few engines for the C7. But GM is notoriously cheap these days. "There's very little chance GM would invest," says David E. Davis Jr., the former editor of *Automobile* magazine who is working with Lutz on the project. Lutz also approached DaimlerChrysler but hasn't been able to strike a deal.

What Lutz believes he has going for him that others didn't is his idea of creating a virtual car company. His plan is for a network of automotive suppliers to furnish parts and assemble them into modules, which would then be shipped to one large supplier that would put the vehicle together. This wasn't possible in the early 1980s, when former GM executive DeLorean tried to start his own company in Northern Ireland. In the years since then, auto makers have thrust onto their suppliers many more design and engineering responsibilities as well as more assembly work.

Basically, what motivates Lutz is a desire to prove people wrong. "If there is conventional wisdom that says this can't be done, Bob will want to do it," says Mark A. Lutz,

Bob's younger brother and a retired economics professor at the University of Maine. That defiance dates back to his childhood, spent in Switzerland and the U.S. Their father, a banker who at 93 still goes into his Zurich office daily, was so strict at home that Bob grew to oppose anything that came as an edict, says Mark. Indeed, when Bob held executive posts at GM's German unit and at BMW in the 1960s and 1970s, he refused to follow European protocol. BMW's Quandt family expected Lutz to kiss the hands of aging baronesses at social events. He didn't. GM forbade him to ride his motorcycle to work or to race his car. He continued

to do so. Eventually, he returned to U.S. to work for Chrysler.

That same brassy approach may recharge Exide. When he took helm in late 1998, some colleagues thought Lutz had made a big mistake. The battery maker was bleeding money, had racked up \$1.3 billion in debt and was being investigated for selling Sears, Roebuck & Co. lower-grade batteries marked as premium ones. "It was not a functioning company," Lutz says. Since then, he has written off millions of dollars in bad investments, paid \$27.5 million to settle fraud charges against Exide in relation to

the Sears case, invested ancillary businesses, and closed plants. He has dumped its highly leveraged but unprofitable deal to supply Sears Roebuck batteries after several years of losses, Exide ekes out profits of \$7.8 million in 1999 and 2000. Now, though, he wants to contend with weakening auto business that is dragging down battery makers.

Salvaging his company would be enough to satisfy some executives. But Lutz wants to see Cunningham carrying down a high profile before he is "enough." Nonetheless, "I don't think Bob knows if he can pull it off," says his brother. Chances are he can't. But he will at least get closer to anybody else who has had a high day job to fall back on.

By David West

'WE DIDN'T KNOW EVERYONE WAS GOING TO BUILD SUCH UGLY CARS'

Your comment on the concept sports-utility vehicles at the Detroit Auto Show in January—that they "resembled angry kitchen appliances"—was pretty harsh. What's wrong with the cars you saw there?

They're all starting to look the same. They had goofy, jagged tail lights, trapezoidal wheels. There must have been 20 vehicles that looked like that. But they'll get it right.

Is there anything that worked well at the show?

The only car at the show that people liked was the Buick Bengal [a convertible roadster that was shown as a concept car]. It has a beautiful, fluid, exquisite shape.

Since your days at Chrysler, you've

wanted to bring out a prestige luxury car. Why?

America has no prestige luxury brand. Cadillac and Lincoln self-destructed by going after fleet business. The goal is to produce an American alternative to European prestige cars.



LUTZ: The latest SUVs look like "angry kitchen appliances"

Why do you think your Cunningham concept car was such a hit at the auto show? Did you expect that?

We didn't know everyone was going to build such ugly cars.

What are your thoughts on DaimlerChrysler's current troubles?

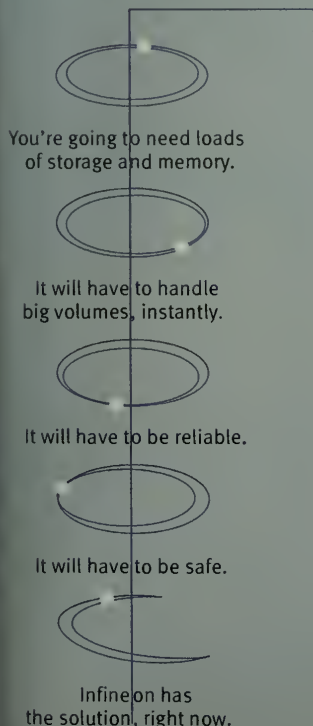
It doesn't break my heart. But it's a source of considerable emotional and financial disappointment. [Lutz still owns shares in the company.]

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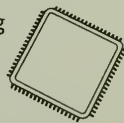
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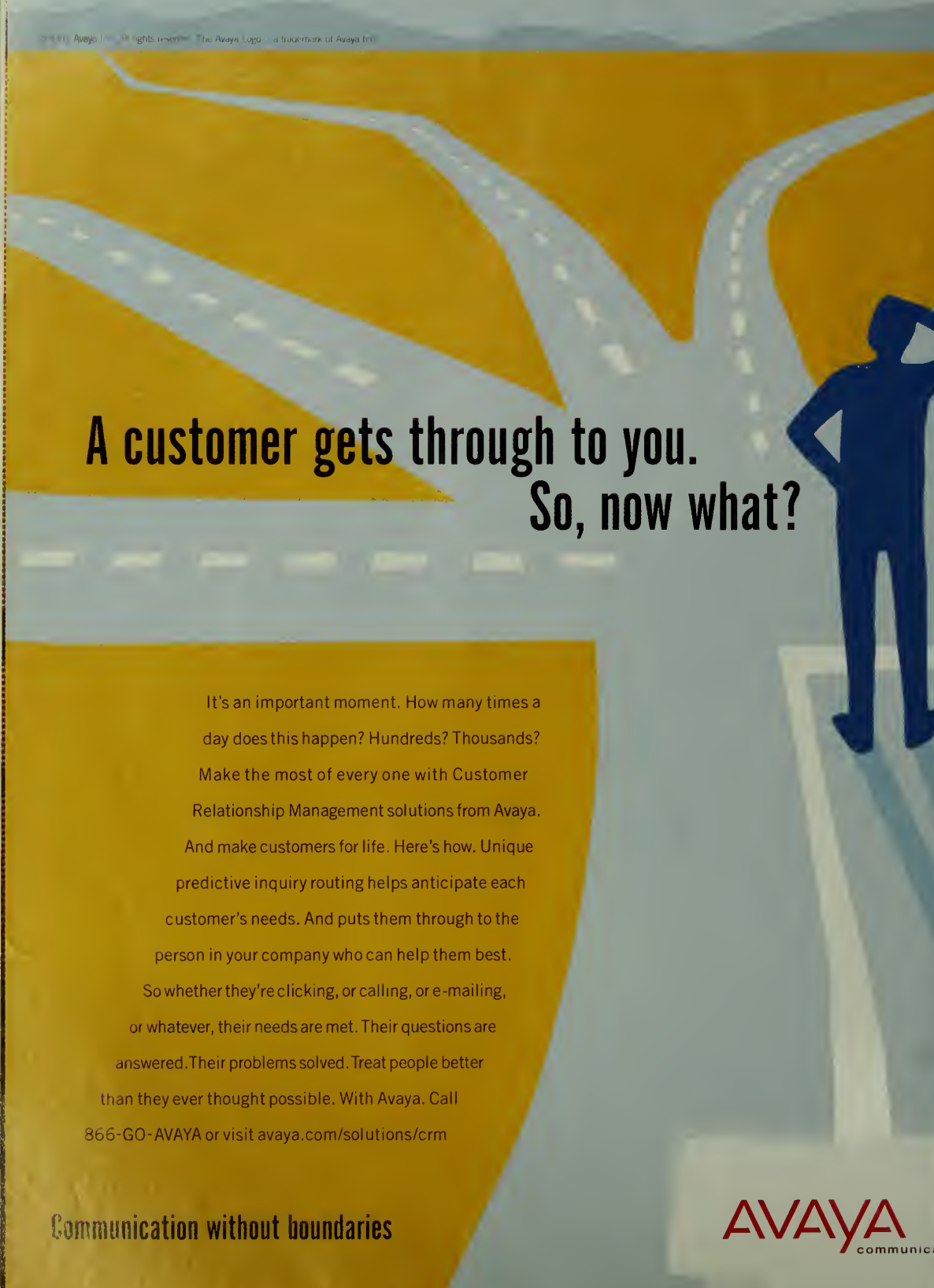
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PATIENTS' RIGHTS COMES OFF THE CRITICAL LIST

With the Senate shift, Bush may have to soften his opposition

For years, passage of a Patients' Bill of Rights has been stalled as a debate rages in Washington over the potential costs and the possibility of away liability claims against employers. Although the public, fed up with HMO hassles, seems eager for reform, a titanic struggle among lawyers, insurers, and health-care providers has kept a bill of rights in legislative limbo.

All that changed on June 5 when Vermont Senator James Jeffords bolted the GOP to become an independent. With control of the Senate now in Democratic hands, the scales clearly are tipping toward a measure that would allow patients to sue their insurers. Senate Majority Leader Thomas A. Daschle (D-S.D.) promised to bring a bill to the floor by mid-June. Its sponsors, Senators John McCain (R-Ariz.) and Ted Kennedy (D-Mass), claim to have 58 votes. In the House, Representative Charlie Norde (R-Ga.), will push a similar bill that could pass in August.

TACK. Although President Bush is turning up rhetorical heat on McCain-Kennedy and has praised a rival that has a more limited right to what he may have to compromise. With term elections looming and health-reform polling high among voters, Republicans will need to avoid being seen as anti-consumer. "Bush doesn't want to go into 2002 without [some] patients' rights," says Robert Laszewski, president of Health Policy & Strategy Associates, a consulting firm. "This is going to be an incredibly close election, and neither side can take

any chances of being perceived as the bad guy."

Faced with a new reality, business is changing its game plan. "A just-say-no strategy isn't going to work this time," concedes Dan Danner, chairman of the Health Benefits Coalition, a high-

courts—which tend to be more sympathetic than federal courts—for denying benefits or providing poor care. Patients also could sue for up to \$5 million in federal court over disputes such as eligibility for medical procedures. Those provisions, business says, would increase corporate costs for health insurance, expose companies to litigation, and force employers to drop benefits. "It is the worst version of patients' rights yet," says Neil Trautwein, director of employment policy at the National Association of Manufacturers.

Industry's biggest concern is that workers would be allowed to sue self-insured employers, generally the largest companies. Labor unions that offer insurance plans have similar concerns and will join with business to oppose the provision.

Kennedy says he's open to compromise. "We're willing to make some adjustments," he told *BusinessWeek*. But he plays down concerns about liability, saying only companies that make medical decisions are affected: "No one is interested in creating employer liability if they're not involved in decision-making," Kennedy says.

FENCED IN. Bush thinks any kind of employer liability is a bad idea. Even with the Senate dynamic changed and a bill looking all but inevitable, Bush economic adviser Mark McClellan repeated the threat of a White House veto. That only set off a round of griping by corporate lobbyists, who say the White House needs to tune into political reality.

Senate moderates who want a compromise say

they're being fenced in by Bush's stubbornness on one side and panicked business execs on the other. They fear that McCain-Kennedy's good intentions could boomerang if businesses drop coverage and increase the number of uninsured.

Still, the smart money is on all sides getting together. Democratic control of the Senate, voter demands for reform, and a looming election seem aligned to give patients' rights the final push.

By Lorraine Woellert, with Phoebe Eliopoulos, in Washington

A Patients' Bill of Rights

The McCain-Kennedy bill of rights would cover all 161 million Americans with employer-based health insurance. Under the plan, you would have the right...

► ...to choose your own doctor.

► ...to independent, external reviews of medical decisions made by your health plan.

► ...to sue your health plan in state court for medical decisions that result in injury or wrongful death.

► ...to sue your health plan in federal court for up to \$5 million in punitive damages over decisions resulting in injury or death.



McCain



Kennedy

powered industry group leading the fight against the bill. Corporate pragmatists want Bush to abandon his hard line and focus on fixing employer liability and sweetening the pot with health-care tax credits for individuals. That would give small-business owners an incentive to buy health coverage—and provide cover for Republicans voting for the bill. But such changes won't fly with Kennedy.

McCain-Kennedy would allow patients to sue their insurers in state

PRAGMATISM Even corporate lobbyists are saying that the White House needs to tune into political reality and abandon the hard-line rhetoric

TODAY

Develop smart highway systems to help traffic move more smoothly

TOMORROW

Think up new excuses for being late to work

TOYOTA



"The dog ate my alarm clock."

"My long-lost uncle dropped in for tea."

"A squirrel short-circuited the garage door opener."

There will always be plenty of excuses for not getting to work on time. But in the future, traffic may not be one of them.

In San Diego, Toyota has tested a highway system that helps vehicles automatically maintain a safe distance from each other, regulating traffic flow. And our engineers are also developing on-board computers that monitor traffic congestion, suggest quicker alternative routes — even locate vacant parking spaces.

But that's just the beginning. We won't stop until bumper-to-bumper crawling is a thing of the past. And to those who say that's not possible, we have just one thing to say. Excuses, excuses, excuses.

www.toyota.com/tomorrow

EDITED BY WILLIAM ECHIKSON



TRAPPING THE WEB TRAP R THIEVES

ALLY, A CAR ALARM FOR the Internet Age. Japan's Iron Corp. and Tokio Marine & Fire Insurance Co. teamed up to create a worked antitheft tool. It only triggers a conventional alarm, but also sends a message to the owner's mobile phone and tracks the car's location so police can recover the vehicle.

The system relies on up to 10 sensors in the car's battery, engine, ignition, doors, and trunk. These communicate with a computer server endlessly over the Internet. The system avoids false alarms by analyzing the car's movement. If, for example, a car bumps into the car's bells don't start a-ringing. The system runs on electricity from the car battery, and the owner is contacted when the voltage changes—something that might happen if a thief unhooks the wires. Despite Japan's image as a safe country, car theft has risen 63% in the past three years. That makes this digital car-cop a bargain at \$335, plus \$6.75 a month in phone and computer charges. Starting in September, manufacturers like Omron will likely sell the system through car dealers, repair shops, and auto insurers. Tokio Marine & Fire is considering giving policyholders a break on their insurance premiums if they install it. Next year, the system goes on sale in Europe and the U.S.

Ken Belson

BIG BLUE IS TEACHING SILICON A NEW TRICK

INTEL CO-FOUNDER GORDON Moore has always insisted that shrinking the size of transistors and circuit lines is only one aspect of Moore's Law—the edict that chip power doubles every 18 months. Just as important, he says, is “cleverness” in designing chip layouts and in engineering new materials. In that arena, IBM gets the cleverness prize for innovations such as the switch from aluminum to copper microwires on chips.

Now, Big Blue has unveiled another breakthrough. It's called strained silicon—but don't be misled by the jargon. “Strain” isn't a negative. Instead, it means electrons can jump through transistors up to 70% faster. Combined with copper wires, which already

allow electrons to flow more quickly, a chip's total speed gain should be around 35%—assuming the same-size circuitry, IBM predicts.

What gets strained is the structure of silicon's crystalline lattice in ordinary chips. Building on the technology it uses for high-speed telecom chips, IBM grows the silicon on top of germanium, which has slightly larger spaces between its atoms. The germanium atoms tug at their silicon companions, and the silicon atoms strain to line up. This opens up more space through which electrons can flow without bumping into an atom. “It gives you a fundamentally new plateau to start from,” says Bijan Davari, vice-president of development at IBM Microelectronics. Look for the new technology to show up in workhorse computer chips by 2003. *Otis Port*

COPPER: AN EMBRYO'S BEST FRIEND

GOT COPPER? THE METAL IS AN IMPORTANT NUTRIENT, found in foods such as shellfish, beans, and chocolate. And it may be more important to the healthy development of unborn babies than scientists imagined.

In the June 5 issue of the *Proceedings of the National Academy of Sciences*, researchers at University of Michigan Medical School describe the development of mouse embryos deprived of a protein that helps copper get into cells. All of the embryos in the study died 10 to 12 days after fertilization. They were also much smaller than normal and exhibited major cellular defects. Since the gene responsible for making the copper-transport protein is nearly identical in mice and humans, the researchers believe copper plays a similarly important role in human prenatal development. Scientists have long realized that copper helps the body metabolize other nutrients, such as iron. “We've known that copper deficiencies can cause diseases in humans,” says Dennis J. Thiele, the University of Michigan biological chemistry professor who directed the study. “But now it looks like you literally can't be born without it.”

Darnell Little

OF MICE
AND MEN:
A SIMILAR
PROTEIN



INNOVATIONS

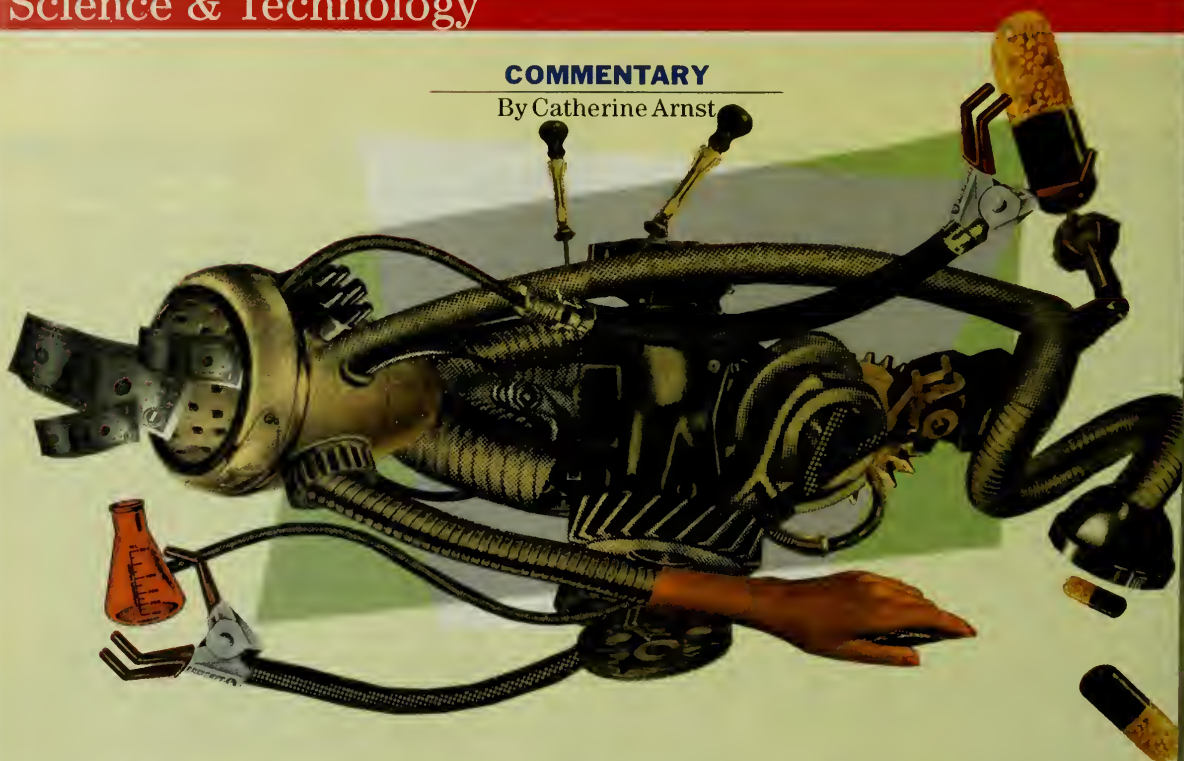
■ More and more of the everyday objects around us are made from plastics. So it's no surprise that these manmade materials are clogging landfills. But not all waste comes from discarded consumer products. Some of it is scrap from factories that make plastic parts. The plants don't recycle all their waste because the properties of many industrial polymers degrade each time they're heated and molded. Now, John P. Coulter, a mechanical engineer at Lehigh University, says that he has found a way to recycle lots of waste plastic. Even parts made with 50% scrap, he says, can turn out stronger than those molded from 100% new polymers. His secret? Using a jackhammer-like action to pump the last dregs of molten material into a mold. That causes the polymer molecules to line up in long strands—almost like fiber reinforcements.

■ Californians have been clobbered with rolling blackouts, and they're fretting about more to come. To help business and consumers anticipate electricity shortfalls, Lawrence Berkeley National Laboratory has developed a Web site that shows, minute by minute, the state's total demand for electricity and its available supply. The Web site—<http://energycrisis.lbl.gov>—also offers tricks consumers can use to trim their use of electricity by 20%, to qualify for rebates under the state's new stingy-energy program.

■ Picnickers may soon stand less chance of getting burned—by fire ants. Researchers at the University of Florida are releasing flies that attack the ants, whose burning bites have become all too familiar since they were accidentally imported 60 years ago from South America. There, the flies keep them in check. *Otis Port*

COMMENTARY

By Catherine Arnst



BREAKDOWN: AS FUNDING DWINDLES, NEW DRUGS STALL

The plaintive letter Cel-Sci Corp. sent out to shareholders on May 31 is both poignant and typical. The biotech company, based in Vienna, Va., is developing novel immunotherapy treatments for AIDS and aggressive forms of cancer—but despite some promising data, its stock is down from \$9 a share in 2000 to \$1.40 in early June. The stock's collapse, along with the rest of the biotech sector, comes just as Cel-Sci is laying plans for costly late-stage clinical trials. "The faith of even the strongest believers is severely tested at times like these," writes CEO Geert R. Kersten. To persuade his shareholders to stay in the fold, Kersten runs through a history of today's biotech stars—how Amgen, IDEC Pharmaceuticals, and Biogen once struggled for survival.

History, it seems, is repeating itself. It's not a great time to be a biomedical startup, even though it's a rare week that there isn't news of an amazing new biotech drug aimed at previously untreatable cancers, brain diseases, or immune disorders. The deciphering of the human genome, combined with advanced drug-discovery technologies and huge leaps in knowledge about the inner workings

of cells, guarantees that these discoveries will continue at an even faster pace. In fact, a record 21 biotech medicines were approved by the Food & Drug Administration last year, and there are 350 more in advanced stages of development.

And yet the Nasdaq biotechnology index fell 25% in the first three months of 2001, compared with a decline of 19.71% in the overall index. Though the index has climbed back in recent weeks, biotech stocks are nowhere near their highs of last year. As a result, only three biotech companies had gone public by May 31, compared with an average of 25 initial public offerings per quarter last year. **UNFAIR.** Private funding is not picking up the slack. PricewaterhouseCoopers says venture-capital financing in biotech dropped off 37% in the first quarter from the previous three months (chart). "The biggest issue facing the biotech industry today is access to capital," says

Hollings C. Renton, chairman of startup Onyx Pharmaceuticals Inc.

Virtually everyone in the industry agrees that biotech has suffered collateral damage from the punctured dot-com bubble. This seems particularly unfair, given that health care was always the poor relation at information technology's groaning board. Market research firm VentureOne Corp. reports that the percentage of the total venture-capital pie devoted to life sciences shrank from 27% to 9% over the past five years, despite big increases in biotech financing. Several large

diversified funds, among them Mayfield, Accel International, and Menlo Ventures, exited the life sciences field altogether. "The Internet was uncharted territory, and when you are making 100 times your money in a year, it's hard to get excited about other sectors," says James

LIFE-SCIENCE INVESTMENTS TAPER OFF



Tananbaum, a managing partner Prospect Venture Partners.

Biotech does have its negatives, of course, not the least of which is its own speculative bubble in the early 1990s. Back then, fortunes were raised and squandered by startups ill equipped to shepherd their discoveries from lab to market, typically a 10- to 15-year process. Today, biotech has a proven track record and big scientific advances behind it, but it still can't promise a quick return. A recent survey by the journal *Nature Biotechnology* found that 82% of 51 publicly traded biotech companies have revenues of less than \$50 million, and only 21% are profitable. Since it can take anywhere from \$100 million to \$500 million to bring a new drug to market, investors must display considerable patience.

OUT IN THE COLD. The biggest loss for society may be the plight of the small fry. Well aware of the slow payoff, big venture-capital funds rarely get involved in biotech startups. The funds that do specialize in biotech are being very selective—and all too often, the lone scientist with a great idea is left out in the cold. "There is plenty of private money around, but it's not being spent," says Alan G. Walton of Oxford Bioscience Partners. "Venture funds are using their money to keep their existing companies going, and that probably means there are somewhat fewer startups."

In this business, though, the lone scientist with a new idea is often the one with enough passion to slog through the harrowing development process. There are 373 companies developing just one drug, says a new survey by market researcher armaprojects. These treatments will not all pan out, of course, but it's sad to think that potentially life-saving drugs will fall by the wayside for lack of funding.

As an object lesson, look at Gleevec, a new treatment for a previously incurable form of leukemia. Novartis came close to undoing Gleevec when it inherited the drug after its merger with Hoechst Ltd. The drug's discovery, Oregon Life Sciences University scientist Dr. Brian Druker, bided long and hard to keep it in the pipeline. Let's hope other remarkable treatments don't land on the same sacrificial altar as Gleevec.

Senior Writer Arnst covers science and medicine.

Marketing



MOVIES

ATLANTIS, DUDE?

Disney is going all out to woo a distinctly non-Disney crowd

The 48,000 folks who trooped through the San Diego Convention Center last July for the annual Comic-Con International gathering were typical comic-book lovers. Mostly boys from 16 to 24, they scoured the 600 booths for kung fu videos, vintage Batman comics, or new stories featuring female wrestler Chyna. Many also wandered into a booth where they could catch a 10-minute segment of a dark animated film called *Atlantis: The Lost Empire*.

Nearly a year before the film was scheduled to hit theaters, Walt Disney Co. was trying to create buzz among a segment of the movie audience that cringes at Disney's warm, fuzzy characters. Its hope is that by drawing an expanded audience to a bold action adventure, it can revive an animation franchise that seems to be losing luster among its traditional audience of younger children and their folks. After years of easily passing \$100 million at the box office, recent Disney animated films have struggled to hit that mark. So while *Atlantis* might turn a profit even as a modest hit, the bigger challenge for Disney is to create durable characters that will generate a long-term stream of revenue from videocassettes, merchandise, and spin-offs.

Compounding the challenge, the PG-rated film, which cost \$90 million to make, rolls out on June 15, the same weekend as Paramount Entertainment's similarly teen-targeted *Lara Croft:*

Tomb Raider. "You never count Disney out, but it is a tall order to get teens to go out to watch one of their animated films," says Paul Dergarabedian, president of Exhibitor Relations Co., which tracks films for theater owners.

COOL LOOK: Will the comics crowd buy it?

NEW TRICKS. To get the word out on *Atlantis*, Disney will go with some tried-and-true tactics: an estimated \$40 million on TV ads and movie trailers, and \$50 million from marketing partners like Kellogg Co., which is selling an *Atlantis* cereal. But to pull in the older, Comic-Con types, Disney is resorting to some new tricks. It put a trailer for the film before its Memorial Day blockbuster *Pearl Harbor*, one of the few times Disney has paired an animated film with a PG-13 offering. It has scheduled a prime-time show on the Atlantis myth, with TV stars Melissa Joan Hart and Tom Skeritt as narrators. Disney is feeding the Internet with art from

the movie, designed by Mike Mignola, known in comic-book circles for his work on the cult favorite *Hellboy*. Disney also seeded Web sites with information about the fictitious Atlantean language featured in the

film. And it distributed 12 million copies of an *Atlantis* CD-ROM game at its parks and through marketing partners. "The PC gaming market is 18 to 35 and frequent moviegoers," says Jan Smith, president of Disney Interactive.

Disney will likely need all these marketing ploys to connect. So far, no studio has found a way to make a hit of an animated action film—never mind doing so while contending with *Tomb Raider*'s curvaceous heroine, played by Angelina Jolie. To keep *Atlantis* from sinking once again, Disney will have to lure its usually fanatical fan base and keep its fingers crossed that a bunch of teenage boys will tag along.

By Ronald Grover in Burbank, Calif.



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The logo graphic consists of a square containing several horizontal, wavy lines that resemble stylized sound waves or a signal, rendered in a dark blue color.

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COMMENTARY

By Mike France

WHY PRIVACY NOTICES ARE A SHAM

Do you like junk mail? Look forward to getting telemarketing calls during dinner? Enjoy reading electronic messages about herbal remedies and get-rich-quick schemes?

If so, then you should be grateful for the Financial Services Modernization Act of 1999, the landmark legislation that allowed banks, insurers, and brokers to join forces. The law made it possible for people to get their credit cards, checking accounts, investments, home loans, and health insurance from one company. That's convenient. But the act also gave finance companies the power to make extraordinarily detailed portraits of their customers simply by

merging files about their income, assets, debts, health, spending habits, and other data. This sensitive information is increasingly becoming a public commodity because of the new law. That's scary—and a big reason why so many strangers are invading your life to try to sell you stuff you don't want.

YOUR MOVE. The legislators who wrote the act were aware this might be a problem. So they insisted that the law include some privacy protection. At the time, civil-rights groups suggested giving people direct control over their personal information. Specifically, they wanted to force companies to get permission from their customers before selling personal

data. But this idea sent industryists into orbit. They warned that proposal—which would have created so-called opt-in system—would cost a fortune to administer.

So the industry proposed another approach: putting the burden on consumers to protect themselves. Rather than forcing companies to get permission before sharing personal data with their customers, lobbyists suggested that consumers should be required to sign an "opt-out" form barring financial institutions from selling the information. Companies trumpeted this as a market solution. Don't have Congress write regulations protecting peo-

Too Much Gobbledygook

This notice by a fictitious bank is comprised of language taken from several real companies and illustrates many of the typical problems with the recent spate of privacy disclosure notices.

THE PRIVACY NOTIFICATIONS ARE AS ENTICING TO READ AS INSURANCE POLICIES. THEY'RE OFTEN SEVERAL PAGES LONG, AND REQUIRE A COLLEGE EDUCATION TO UNDERSTAND. THEY SHOULD BE WRITTEN AT AN EIGHTH-GRADE LEVEL.

MANY OF THE FORMS TELL PEOPLE THE BENEFITS OF LETTING FINANCE COMPANIES SELL THEIR PERSONAL INFORMATION BUT SAY NOTHING OF THE COSTS.



OUR PRIVACY PLEDGE

Protecting Your Privacy is important to the Orwellbancorp family of financial service providers. Our primary focus is empowering you to meet your financial goals. The purpose of this mailing is to explain how Orwellbancorp protects and uses your personal information. We want you to know that information given to us is safe, secure and used in accordance with all state and federal regulations.

I. BENEFITS OF INFORMATION SHARING: To offer you all the greatest advantages as a Orwellbancorp customer, we find that sharing your personal information with our affiliates and business partners enables us to offer you personalized products and services at lower cost and greater convenience than would otherwise be possible. In today's ever-changing, competitive market, preventing us from sharing your personal information may mean missing offers on money-saving products and services.

II. CATEGORIES OF NON-PERSONAL PUBLIC INFORMATION ORWELLBANCORP MAY COLLECT AND DISCLOSE: This policy principally governs Orwellbancorp's use of non-public personal information. Non-public personal information (NPPI) is defined in applicable federal law and generally means financial information that is identified with you that is not obtainable from a public source. For example, your account balance is NPPI. In contrast, the fact that you may have obtained a mortgage loan from us is public information because the deed of trust is available in public records. NPPI includes any list, description or other grouping of customers that is created using NPPI (whether or not the list also includes public information), but NPPI does not include any list, description, or grouping that is created using only public information. We obtain personal customer information primarily from you (for example, when you open an account with us or submit a loan application). We may also obtain such information from other sources; for example, when you apply for a loan, we may obtain a credit report on you and ask you to verify your personal financial information. We also maintain personal customer information resulting from your experience and transactions with us. For example, we collect and maintain information about our customers, including the following: 1) Identification information, such as account numbers, Social Security Numbers, and PIN codes; 2) Information regarding your creditworthiness and credit capacity, such as your assets, liabilities, employment, income and expenses that you provide to us in a loan application; 3) account activity information, such as loan or deposit balances and transaction histories; 4) Information regarding your financial situation which allows us to recommend appro-

CONGRESS HAS FORCED COMPANIES TO MAIL OUT THESE NOTICES. BUT THEY WOULD NEVER TELL YOU IF IT. BANKS, BROKERS AND INSURERS ARE MAKING IT LONGER IF THEY'RE ABLE TO. IT'S TYPICALLY AFFIRMATIVE, NOT NEGATIVE. TO CUSTOMERS. MEANWHILE, THEY'RE BURDENING THE OPT-OUT

LOSE YOUR LEGAL

gued. Rather, tell consumers
reats to their privacy—and let
ake their own decisions. So long
as was full disclosure, they
everything would be fine.
inance industry won this battle,
unsavory fruit of its lobbying
n is now appearing in your mail-
er the past several weeks, you
obably received more than a
privacy notices. But there's a
ance you have missed many of
because Congress didn't require
es to mail the notices separate-
re frequently bundled in with
perwork and wind up in the
ven if you have noticed them,
e you didn't read very far. The
are about as easy to digest as
anties. They're packed with
written in small print, and vio-
ost every known rule about how
complex ideas comprehensible
verage consumer (table). "Every
get a letter from somebody

telling me that I've just won \$1 million.
If I throw that away, there's no way I'm
going to read one of these," says Alan
L. Dorris, an Atlanta industrial engineer
who designs warning labels.

So far, the opt-out forms are being
returned by about 1 in every 20 con-
sumers. The American Bankers Assn.
has the nerve to say this is because
people aren't all that worked up about
privacy. Please. The real reason opt-out
rates are so low is because the notices
are designed to be ignored.

BAD START. In fact, they make a mock-
ery of the fundamental idea behind the
opt-out approach: that consumers will
be protected if companies fully disclose
what they do. Disclosure is meaningless
unless people understand what's being
disclosed. If they don't, then the choice
purportedly being granted—to opt out
of having private details sold like gum
balls—becomes an empty one.

There's no doubt finance companies
could do a better job if they wanted to.

Look at a sales brochure for, say, a
variable annuity. The same principles
used to inform people about sophistat-
ed financial products should also be ap-
plied to privacy notices: plain English,
lots of white space, no legalese.

Regulators also need to draft rules
ensuring that these design edicts are
followed, just as they have done with
insurance and credit-card sales pitches.
So far, the agencies supervising the no-
tices—a task force including the bank-
ing agencies, the Securities & Exchange
Commission and the Federal Trade
Commission—have been part of the
problem. Their initial round of regula-
tions was confusing, the model language
impenetrable. But there's still time to
make amends. Congress has required
regulators to review the notices and
suggest improvements in 2002. Next
time, let's hope they get it right.

*A former lawyer, France is among the
few who actually read privacy notices.*

A Better Way

Banks, brokers, and insurers know how to make complex ideas clear when they want to sell you something.
Here's how privacy notices should look:

MERS
OUT
MAIL-
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D
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M
NALLY.

POSTAGE WILL BE
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NO POSTAGE
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Want To Protect Your Privacy?

PEOPLE WHO
WANT TO
PROTECT
THEIR PRIVACY
SHOULD BE
PROVIDED
WITH SELF-
ADDRESSED,
STAMPED
POSTCARDS.
NOW THEY
HAVE TO
WRITE A
LETTER AND
PROVIDE
THEIR OWN
STAMP.

Dear Mr. Johnson,

We know a lot about you, including your income, assets, liabilities, and insur-
ance claims history. Our records also show where you work, where you live, what
you buy, and the names of your family members.

We occasionally sell this information to telemarketers. We also give it to our
affiliates so they can try to sell you products and services that you may find useful, such
as credit cards, insurance, and investments.

A new federal law requires us to tell you about the personal information we have
and gives you the right to prevent us from selling it to other companies. If you ex-
ercise this right, you will not receive some product offers. Do you want us to con-
tinue selling information about you to other companies?

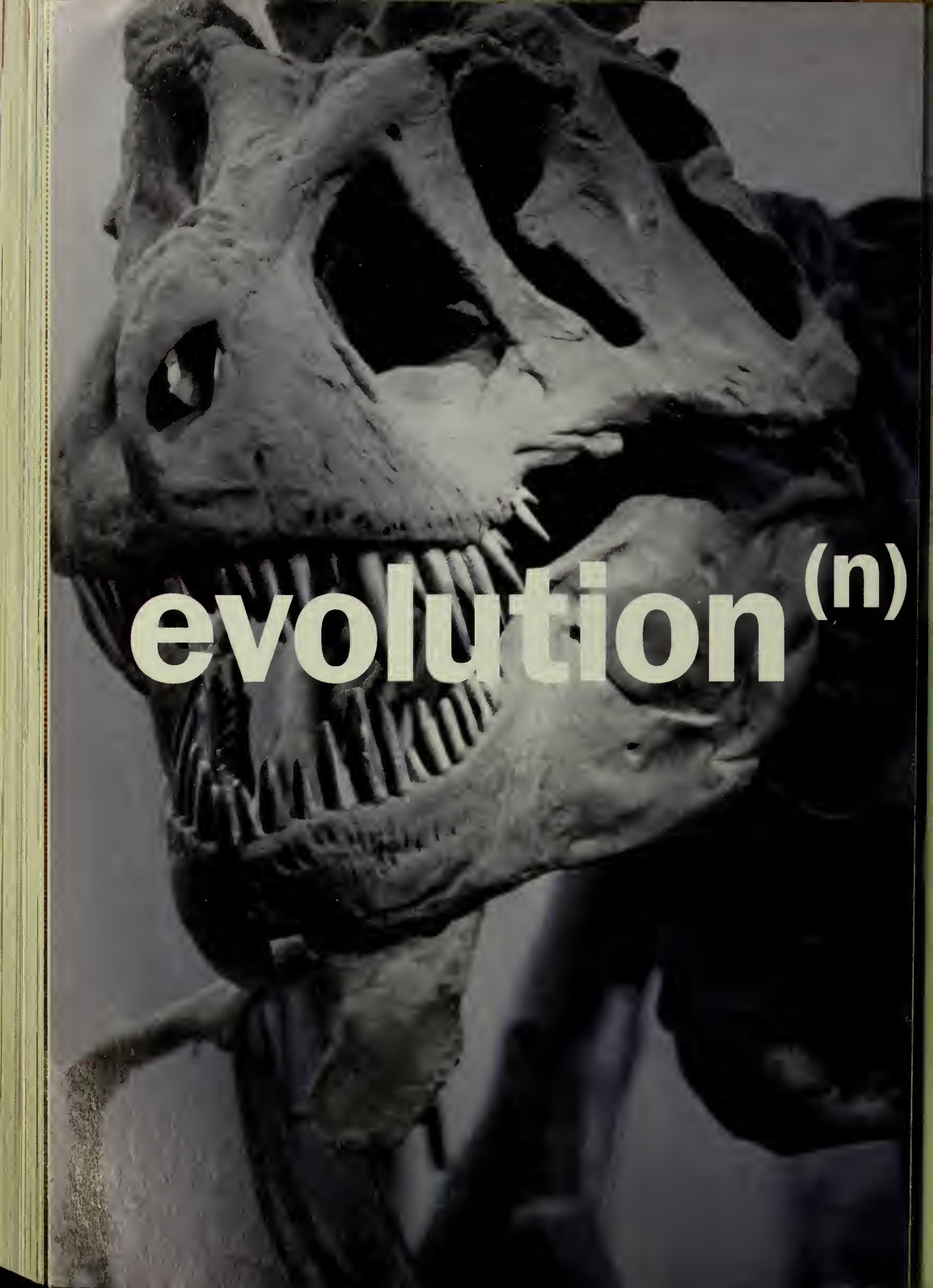
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SPORTS AGENTS

SPARKS FLY AT SFX

Can the management powerhouse—created almost overnight—hang together? Super-agent David Falk's curious decision



FALK GUYS:
*Clients of Falk (left)
include Michael Jordan
and Allen Iverson*



David Falk may be the most powerful sports agent ever. With his shaved head and ready-for-combat countenance, he is certainly the most fearsome. For two decades, Falk and his haughty negotiating style have been complicating the lives of the teams he bargains with—and showing the money to a list of star clients that includes the best basketball player today (Allen Iverson) and the best ever (Michael Jordan).

So it was more than a bit curious when Falk, 50, announced in April that he is throttling back his hard-driving career. According to execs at SFX Sports Group, the sports-management powerhouse he helped to create, Falk has voluntarily given up his title as chairman to leave him more time to spend with his family.

Falk's competitors in the sports-agent biz still haven't stopped tittering. In fact, it's hard to find one who accepts the story at face value.

Few doubt that Falk will be a major force in their industry for years to come. But many agents question the future of SFX Sports, whose list of clients brims with World Series heroes, bas-

ketball MVPs, and a tennis champ, Andre Agassi. And Falk's stormy tenure isn't the only reason.

Since entertainment-and-sports conglomerate SFX was sold to Clear Channel Communications Inc. last August for \$4.4 billion, SFX Sports has been buffeted by controversies. They include a conflict-of-interest brouhaha involving principals of Clear Channel, the San Antonio-based media giant that controls 1,170 domestic radio stations and owns some 700,000 outdoor-advertising displays. Although Arn Tellem, the super-agent who represents Kobe Bryant and is assuming some of Falk's duties, suggested that the famously loquacious Falk would be available for this article, Falk declined to comment. But L. Lowry Mays, chairman and CEO of Clear Channel, told *BusinessWeek*: "We like the business, and I don't see any reason to exit the business." And he adds: "Last time I talked to David Falk, he was very happy. He expected to be with the company for some time."

The conflict-of-interest flap arose because two pro-sports franchises (the Texas Rangers and Dallas Stars) are owned by the vice-chairman of Clear

Channel, Thomas O. Hicks, and one Minnesota Vikings) is controlled by major shareholder, Red McCombs. appearance that agents report to the moguls has called into question the dependence of SFX Sports.

SFX officials say they have tried to solve the conflict problem with a restructuring plan that gives agents greater autonomy. Separate baseball and basketball groups now operate with less oversight from Clear Channel, they say.

"We have total freedom to run our businesses—hire, fire, and do whatever we think is necessary," says Tellem. Players' unions for the four major sports have yet to signal their approval, Tellem adds: "My understanding is very close to having this all resolved. And concerns about conflicts didn't stop SFX from signing nine first-round picks in last year's NBA draft."

Still, the turmoil at SFX runs deep. Agents Jim Bronner and Bob Givens, who sold their Speakers of Sound (SOS) firm to SFX in February, 2000, are to be fired later, are suing SFX Sports Group Inc. and SFX Entertainment Inc. in federal court for \$60 million. They allege that SFX fraudulently with-



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YOU NEED A DIFFERENT KIND OF SOFTWARE.

Sports Business

information about the coming takeover by Clear Channel.

Both sides have agreed to arbitration, but the suit casts a harsh light on the machinations inside a sports empire built at lightning speed. In a 20-month spending binge, Robert F.X. Sillerman, SFX's former executive chairman, engineered the buyout of four elite sports-agent firms for cash and stock totaling about \$200 million. Sillerman's most expensive and high-profile purchase was Falk's agency, F.A.M.E., which cost \$120 million, including \$82.9 million in cash. The acquisition spree, which ended six months before the Clear Channel takeover, brought under one roof agents for about 16% of Major League Baseball players and 18% of NBA players.

EGO CLASH? Not all of the soloists thrown together by this breakneck expansion have adapted well to the go-along-to-get-along demands of corporate life. "These are people who are successful and often ego-driven," says Craig Fenech, a veteran agent with friends at SFX. "At this stage of their lives, they're not going to take well to getting approvals from someone who knows less about how to operate a sports-agent business than they do."

From the start, critics have questioned whether SFX Sports was built to last. Its roots go back to SFX Broadcasting, sold to the predecessor of Clear Channel in 1997, and the company it spun off, SFX Entertainment. With Sillerman and Michael Ferrel, president and CEO, at the helm, SFX Entertainment began rolling up promoters of live performances and venue operators. Then it turned to sports representation.

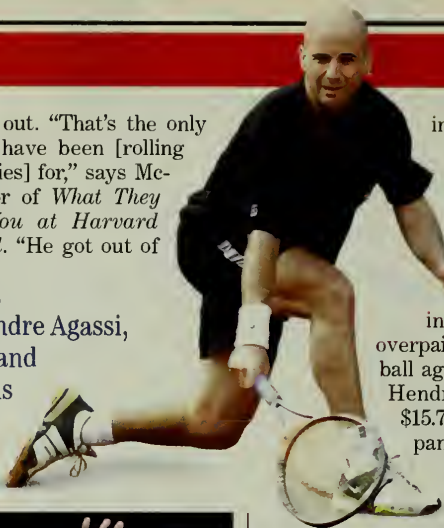
Sports celebs, say industry observers, were a boost to Sillerman's ultimate goal: selling the company at a heady profit. "He's an acquirer of companies, not a builder. His interest is in the endgame," says Bob Gutkowski, a former SFX exec who was forced out in a bitter dispute with Sillerman after Falk was chosen to run the sports group. Gutkowski is now president of Magnum Sports & Entertainment Inc.

Mark McCormack, head of International Management Group (IMG), the sports-marketing and management behemoth whose closest rival is now SFX Sports, predicted weeks before the deal with Clear Channel was announced that Sillerman would sell out.

"That's the only thing he could have been [rolling up sports agencies] for," says McCormack, author of *What They Don't Teach You at Harvard Business School*. "He got out of

HERE TODAY...

SFX clients Andre Agassi, Kobe Bryant, and Roger Clemens could jump ship at any time



it with billions. But that doesn't mean the business model works."

Sillerman, who left SFX after it was sold, rejects such talk. He says flatly: "I've never in my life been involved with a company built to be sold."

Creating an SFX sports division turned out to be none too difficult. Top agents who had spent their careers cobbling together lists of star clients were happy to cash out their businesses, especially at the prices be-

ing offered by SFX. Says McCormack: "I don't know anything about what SFX is in the entertainment business. But even if they were

in sports, they were overpaid for." Veteran baseball agents Alan and Ray Hendricks took in a \$15.7 million for their company, which represented future Hall of Fame pitcher Roger Clemens. Gilhook

Bronner, and their partners at SOS, whose clients included Sox pitcher Pedro Martinez, picked about \$30 million. For his \$120 mil payday, Falk agreed to go to work SFX for five years and, if he left before the deal expired, not to compete in sports-agency biz for one year.

FREE AGENTS. Not always clear, though, was what SFX's millions were buying. Agents joining SFX agreed to sign over revenues due them from player contracts and endorsement deals already negotiated, sometimes with payments going four or five years into the future. But players weren't part of any deal. Dan, for example, is free to take a vacation on Falk—and SFX. Sillerman, who worked with Jordan before finalizing the deal with Falk, says such scenarios were fully considered before offers were made.

Still, experienced agents say it's risky to bank on the loyalty of mercenary stars. "In our business, we have a motto: Every hour of every day, directly or indirectly, someone is trying to steal your client," says Steve Kauffman, a veteran agent for NBA players.

For now, Clear Channel seems committed to holding on to its star-crossed sports group even though it's a minus part of the \$8 billion company. "If Roger Clemens got hit by a bus, as a Yankee fan, I'd be upset. But it would be a great event for Clear Channel," notes William Meyers, an analyst at Lehman Brothers.

Meanwhile, the continuing tug-of-war among sports agents is that Falk will like to reclaim F.A.M.E. from the clutches of Clear Channel. One potential sticking point: how much of that million bucks he'd have to give back.

By Mark Hyman, with Skip R.

BusinessWeek online

For a more extensive version of the interview with IMG chief Mark McCormack, go to the 18 issue at www.businessweek.com

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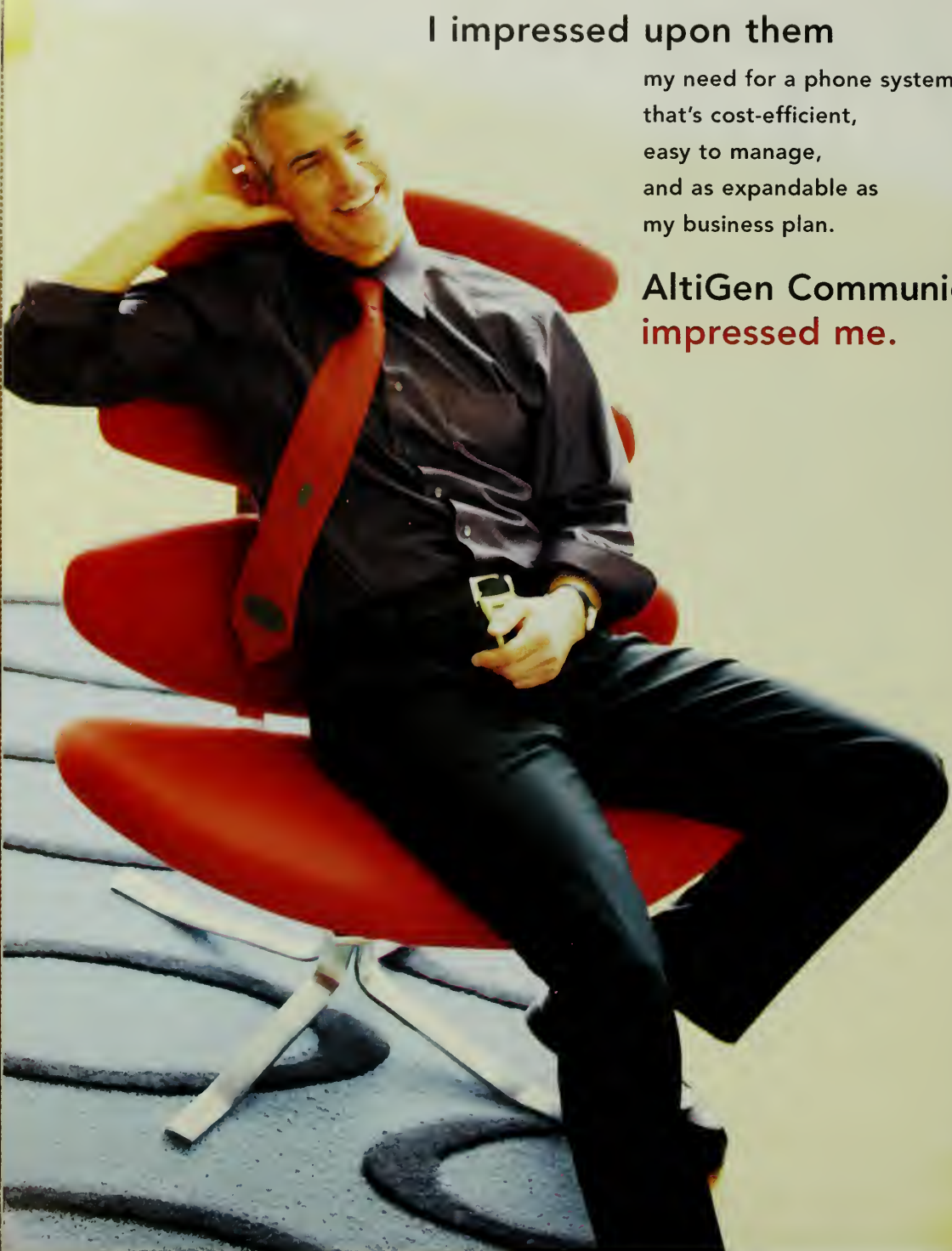
THE RESOURCE FOR ENTREPRENEURS JUNE 18, 2001

THE NEW IMMIGRANTS

How Foreign-Born
Entrepreneurs Are
Changing the
Face of American
Small Business



KOLA emigrated from India, founded a U.S. software company and sold it for \$7 million



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BusinessWeek Small Biz

6/18/2001

FEATURES

16 Cover Story The New Immigrants

Forget the huddled masses: These newcomers are energetic, entrepreneurial, and sometimes even rich

22 Strangers Who Sell

In the effort to keep their payroll down, more small companies are outsourcing their sales function—with mixed results

Cover photograph
by Thomas Broening

WE'VE FROM OUR WEB SITE.

**Small Biz
ONLINE**

Cash Crunch?

Banks continue to tighten up on small-business lending, say May data from the Federal Reserve, but at a slower pace. Just 36% imposed stiffer terms, down from 45% in the first quarter. By contrast, 50% tightened terms on big companies.

Send 'em Home

If your staff is so busy that they pass up vacation, they're hurting your business. A study of overwork finds they're more likely to make mistakes, suffer health problems, and go job-hunting. Worse still, they don't step back to reflect on what they're actually doing.

Failures Rise

Bankruptcy filings by private companies surged 50% in the first quarter, but that may be temporarily inflated. Pending changes in the law could make it tougher to discharge debt, so lawyers say many are filing now.

For the full stories, visit smallbiz.businessweek.com

Supplement of BusinessWeek Magazine
11 Avenue of the Americas NY, NY 10020

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OUTSOURCER:
Derek Holloway
uses outsiders to
sell his medical
equipment (page 22)

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iNBOX

EDITED BY KIMBERLY WEISUL

Web Weary

SMALL BUSINESS GIVES E-COMMERCE THE HEAVE-HO

THE E-COMMERCE SLUMP ISN'T RESTRICTED TO DOT-COMS. Small fast-growing companies of all stripes are backing away from the Web, says PricewaterhouseCoopers. Just 29% of fast-growth CEOs expect to be selling online next year, down from 42% last year. Those planning to do so play wares online and close sales by phone fell from 64% to 36%. Pundits blame the weak economy, dot-com failures, and techno-confusion.

Even thriving, tech-savvy companies find online sales tricky. "Demographics on the Internet aren't right for us in terms of direct sales or even leads," says Lawrence Weinberg, CEO of 65-employee BOWA Builders in McLean, Va. Weinberg builds \$2 million to \$3 million homes in a tight geographic area but gets Web visitors from far away who want about \$118,000 houses. The Web may be global, but BOWA isn't.

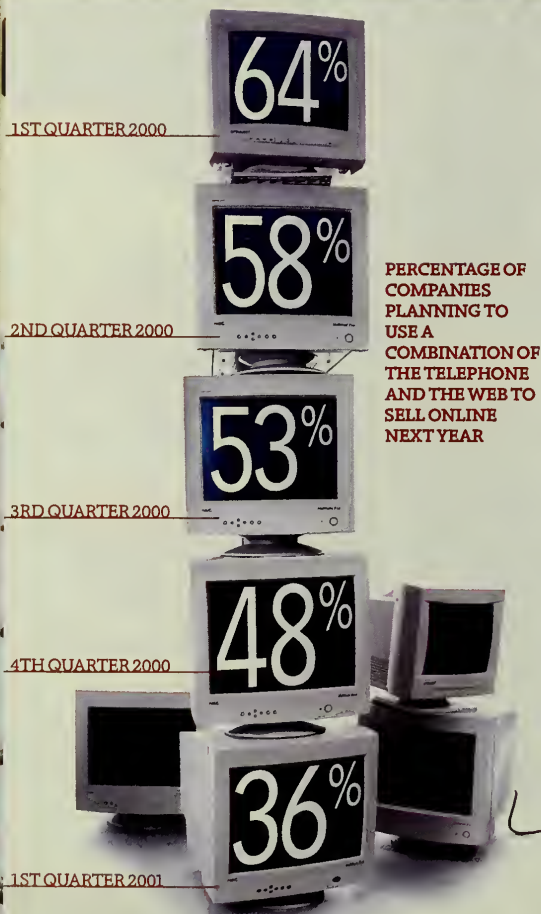
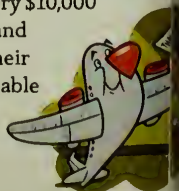
SO THEY SAY

"You can't let these people just go off on their own"

—JUDI FLOWERS, co-founder of *Bonjour Fleurette* on the need to closely supervise an outsourced salesforce (page SB25).

Scoring Points on Frequent Fliers

American Airlines is easing the pain—or is it pangs?—of letting employees rack up frequent-flier miles on your dime. As of January, its Business Extraa plan awards employers points for every \$10,000 spent with American—and employees can still get their miles. Points are redeemable for flights and upgrades. At businessextraa.com.



ONE IOTA

THAT'S JUST FINE
Percentage of OSHA fines on small companies that were eventually reduced

Data: General Accounting Office

100



Blind Bites
Wendy Weiss, the author of *Cold Calling for Women* and president of Weiss Communications, a sales training company, on making cold sales calls:

What mistakes do cold callers make? The biggest mistake is simply not making the call. The next biggest mistake is not getting the point. That happens when people let their fear overcome them.

How do you conquer your fear? Recognizing that you're coming from a place of integrity—your personal integrity and the integrity of what you're doing. Be prepared—develop your marketing plan, and write your script.

What should your script say? Tell them who you are. Explain what differentiates you from everyone else in the world who's doing the same thing. Then you must ask for what you want. If you write your script in perfect English, it sounds stiff. Try making it into a tape recording and then write it down. Then run it on an 8-year-old. If he can't understand it, you're talking to your prospect wrong. It's not either.

Biophys Ed

SCIENTISTS GET THE STARTUP BUG

PHYSICS ENTREPRENEURSHIP. Sounds like a contradiction in terms, no? Don't tell that to Cyrus Taylor, physics professor at Case Western Reserve University. Taylor is also the director of a new degree program at CWRU—a masters of science in physics entrepreneurship. Two of his biophysics students are off to a good start. Marc Umeno won three business plan competitions with a test to detect heart disease by tracing the progress of a radioactive material through the bloodstream. Classmate Nina Pandey is teaming up with a professor to commercialize a new imaging technique to help scientists track disease in lab mice. The other three students are interested in what the program's associate director, Robert D. Hisrich, calls "intrapreneurship"—academic-speak for being entrepreneurial without giving up a steady paycheck. Considering that physics aims to stretch the boundaries of the known universe, stretching the definition of entrepreneurship is no big deal.



LAB FAB: Students Pandey and Umeno; director Taylor

Reprieve for a Small-Biz Fund?

THE NEW MARKETS VENTURE CAPITAL INITIATIVE, designed to funnel \$150 million to inner-city businesses, could get a new lease on life. Created by the last Congress, the Small Business Administration program was axed from President Bush's budget. Now, with Democrats controlling the Senate, John Kerry is chair of the Small Business Committee—and he backs New Markets. To date, the program's uncertain state has made it hard to raise money to match the federal dollars provided by New Markets, says Kerwin Tesdell, president of the Community Development Venture Capital Alliance, a trade organization. So, New Markets could still grow old before its time.



Sitting Pretty

AS THE COST OF BENEFITS GROWS, ENTREPRENEURS STILL FIND WAYS TO PAMPER THEIR STAFF

64%	41%	11%	6%
of small companies offer flextime, vs. 58% of all companies	let workers telecommute, compared with just 37% of all companies	give extra pay for weekend travel, vs. 8% of all companies	permit pets at work, compared with 4% of all companies

Data: Society for Human Resource Management

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FRONT

LINE

ANALYSIS
IDEAS FOR ENTREPRENEURS

STATS
OF THE MONTH

27%

of U.S. entrepreneurs say their single biggest problem is high taxes

56%

small businesses have fewer than five employees

25%

small-biz owners have household incomes over \$50,000 a year



TECHNOLOGY

URL, Interrupted

SMALL BIZ FALLS PREY TO ISPs GOING BANKRUPT **BY JOAN RAYMOND**

ALBERT, WEILAND & GOLDEN, a small Costa Mesa (Calif.) law firm, recently stumbled into a lucrative new niche: telecom bankruptcies. With the communications industry in disarray, the 34-person firm has been busier than

ever, juggling 20 major Chapter 11 reorganizations involving tens of millions of dollars owed by outfits such as NorthPoint Communications Group, Star Telecommunications, and Pacific Gateway Exchange. But in April,

work at Albert Weiland suddenly slowed to a crawl. Why? Its own Internet service unexpectedly died.

It turns out that Albert Weiland's Internet service provider, which the firm declined to name, contracted with another company for high-speed lines. When that broadband provider went bust, so did the law firm's DSL connection. For nearly a month, lawyers had no e-mail, instead relying on faxes, snail-mail, and delivery services—which meant plenty of stressful delays. The irony, says partner Evan D. Smiley, was rich. "I never thought it would happen to us," he says.

The odds are increasing that it will happen to lots of people. So far this year, at least 20 major providers of digital subscriber lines (DSLs) have shut down, filed for bankruptcy, or found themselves bleeding dangerous amounts of cash. NorthPoint, based in Emeryville, Calif., once one of the industry's top players with

more than 100,000 customers nationwide, closed in March. Soon afterward, Winstar Communications and Teligent went into Chapter 11. And Covad Communications Group, while vowing to stay open, conceded on May 24 that its future is in doubt.

Dozens of small, regional outfits have flamed out altogether.

The result: Some 75,000 small businesses have been plagued with annoying, and often costly, service disruptions, according to AMI-Partners, a New York market research firm. And

the situation promises to get worse before it gets better as even more telecoms stumble, says AMI's Greg Zissu.

Part of the problem is that very few DSL providers actually own the lines that carry the superfast connection. Instead, most are resellers for other DSL providers. Dozens of providers, for example, sold high-speed access through NorthPoint's network. "Everybody is part of some telecom food chain, and if any part of that chain tanks, you're out of luck," says Keith Wechsler, owner of WechTECH Inc., a technology consulting firm in Fort Lauderdale, Fla.

"NO ONE TOLD US"

JUST ASK JAMES R. Adox, a partner at EDF Ventures, a venture-capital firm in Ann Arbor, Mich. One morning in April, Adox arrived at the office to find the company's nine employees complaining that they had no Internet access or e-mail. Adox called his provider, xo Communications Inc., and learned that the company contracted with NorthPoint to provide DSL service. "No one told us about the NorthPoint connection before this disaster," says Adox. xo spokeswoman Nancy Gofus says it's true that service

contracts do not spell out the complicated relationship between provider—and until now, it hasn't mattered. "We've never had anything like this happen before," she says.

EDF, left without a high-speed connection for nearly a month, made do with a slow dial-up modem. Sending or receiving attachments was nearly impossible. Worse, incoming e-mail was frequently bounced back as undeliverable—and the communication failure resulted in canceled meetings with potential clients. "Being on the Net is our lifeline," says Adox. "And we were dead in the water."

HOME REMEDIES

FACED WITH SIMILAR problems, Donald E. Martelli took matters into his own hands. An associate at Boston public-relations firm Morrissey Co., he learned in January that his high-speed Web service, HarvardNet, was bailing out of the business, and that a replacement wouldn't be available for weeks. So Martelli, a 27-year-old former construction worker, reached for his power drill. He haphazardly strung a single phone line through the office's walls and across the floor. Using splitters, he managed to link each of the company's 14 computers to the line, which led to a dial-up modem. Of course, only one employee at a time could use it, severely limiting Web access at the research-intensive outfit. "It was a joke," says Martelli.

Martelli's sense of humor was tested again after he lined up a new provider, Digital Broadband Communications Inc., only to see it go bankrupt before service could be installed. Then left Morrissey & Co. stuck without Martelli's cumbersome setup for several weeks, until it opted for T1 line service at double the cost of DSL. Martelli doubts his problems are over. "I don't think we're out of the woods," he says. "But if I have to go through this again, I'm declaring war." Telecom companies beware: This man is armed with a drill.

@SB For tips on protecting yourself from the telecom meltdown, click Online Extras at smallbiz.businessweek.com

MARTELLI: He went to work with telephone cables and a drill

"I never thought it would happen to us," says a lawyer



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TRENDS

Buy Your Rivals

WHEN TIMES GET TOUGH, THE TOUGH GO SHOPPING

THE ECONOMY MAY BE in low gear, but entrepreneurs are still in the mood to shop—for other companies. According to an April survey by PricewaterhouseCoopers, 41% of CEOs of fast-growth companies say they plan to make an acquisition in the next three years.

Why the shopping spree? For starters, it's a matter of survival, says Steve Hamm, a PricewaterhouseCoopers managing partner. "Accumulation of critical mass is essential to be competitive," he says. But there's more at work. The slumping economy is driving down the valuations of small companies as much as 20% to 30%, says John E. Mack, CEO of USBX Inc., a Los Angeles mergers and acquisitions advisory firm. As a result, entrepre-

neurs with cash on hand are finding bargains that are hard to resist.

"Buying another company means faster expansion," says David Simon, president of B.C. Exchange Inc., a 27-person commercial carpet distributor in New York. In March, 2000, B.C. bought a carpet manufacturer for about \$300,000, a mere 10% of that company's revenues. Now, Simon expects to acquire two more companies, doubling his revenues to \$20 million a year. The price tag: about 20% less than it would have cost a year ago.

An aging population, meanwhile, is driving up the number of sellers. "For all those businesses created by baby boomers, the time has come to cash out," says Chris

AT A GLANCE

The Facts More than 40% of entrepreneurs plan to buy another company

The Reason In a slow economy, there are plenty of sellers and bargain prices

The Future Expect even more M&A activity as boomers who want to retire begin to cash out

Come Together

Businesses cited one or more of the reasons for making an acquisition

66%	COMPLEMENTARY PRODUCTS
63%	NEW MARKETS OR DISTRIBUTION
50%	ECONOMIES OF SCALE
49%	NEW TECHNOLOGY
38%	DIVERSIFICATION
15%	E-BUSINESS CAPABILITIES

Data: PricewaterhouseCoopers

Bennett, vice-president at Asht Partners, a Chicago financial-advisory firm. Indeed, nearly half of the country's small and midsize companies expected to change hands over the next 10 to 15 years, says Chapman Associates, an M&A specialist in Schaumburg, Ill. So entrepreneurs could find themselves in an even more robust buyer's market—presuming they survive the current slowdown.

—NAWEEN A. MAN

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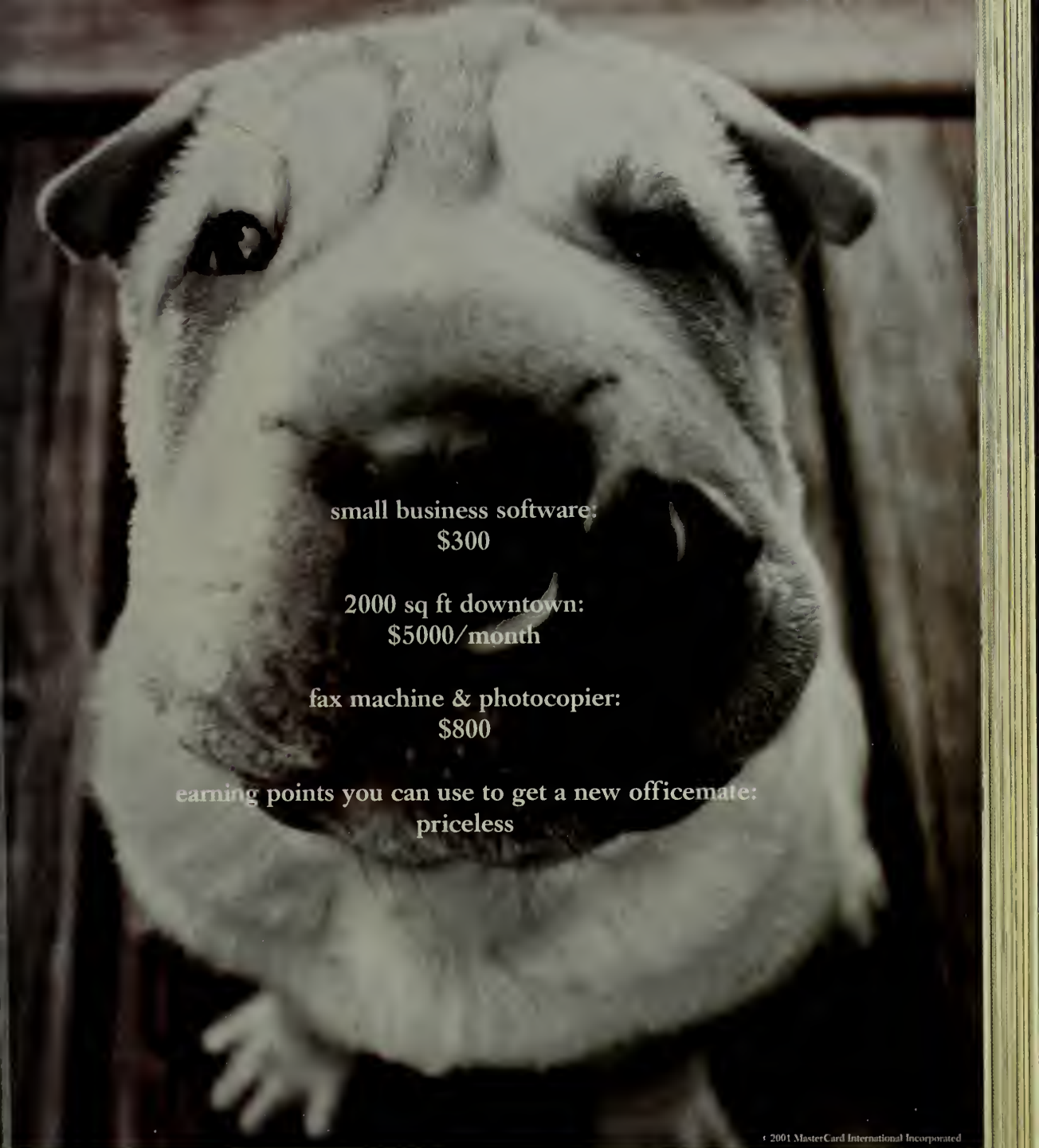
Q What kind of government aid can I get to start a business in a low-income area?
—F.G., Atlanta

A There are plenty of programs, but there's no free lunch. All take considerable time and paperwork, so

check the criteria before diving in. At the federal level, the Small Business Administration gives qualified companies preferred-contractor status (www.sba.gov/hubzone), and the Housing & Urban Development Dept. offers employee-wage tax credits to companies in empower-

ment zones (www.hud.gov). Most programs, though, administered at the state or local level. The best place to start is with your local government's business or economic development department. In Atlanta, contact the Atlanta Empowerment Zone Corp. (www.ezec.gov).

—KAREN E. KIL



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ALL RIGHT NOW: Mayes lowered her weight and cholesterol

WHAT WORKS

Well, Well, Well

EMPLOYEE HEALTH PROGRAMS CAN BE MONEY SAVERS

LAST AUGUST, MELANIE MAYES learned something shocking about herself: "I was a heart attack waiting to happen." At a company-sponsored wellness exam, Mayes, a 25-year-old administrative assistant at ARAG Group, a Des Moines insurer, discovered that her cholesterol level was dangerously high. So Mayes started walking and swimming. She has shed 15 pounds and feels healthier than ever.

For entrepreneurs seeking to control health-care costs, employees like Mayes, who may be neglecting their health, can become big problems. After all, managed-care companies set premiums based on an entire group's claims history. Just one cardiac case can raise your costs for years.

That's why a wellness program makes sense. At ARAG Group, 80 employees receive free annual health screenings at a local hospital. The cost: \$8,000 a year, and worth every cent, says President James R. Brennan.

Since establishing the program two years ago, ARAG's health-care costs have risen by 7%—vs. nearly 10% for all small businesses. How much of the credit goes to wellness? Brennan isn't sure. But he figures that if he's prevented one heart attack, it's money well spent.

If your health plan doesn't cover health assessments, a local hospital can administer exams for \$10 to \$40 a head. The nonprofit Wellness Councils of America (www.welcoa.org) can help you design a program and direct you to regional resources and vendors. Wellness also often results in a drop in absenteeism and turnover. Last year, ARAG's turnover was just 9%, about half the industry average. And with less anxiety about runaway medical costs, perhaps your own heart rate will slow down. —JOSHUA KENDALL

@SB For more information on setting up a wellness program, click Online Extras at smallbiz.businessweek.com

INSTANT EXPERT



DOT-COM FIRE SALES

With so many companies folding, it's a good time to upgrade your own

technology or furniture—by buying their leftovers.

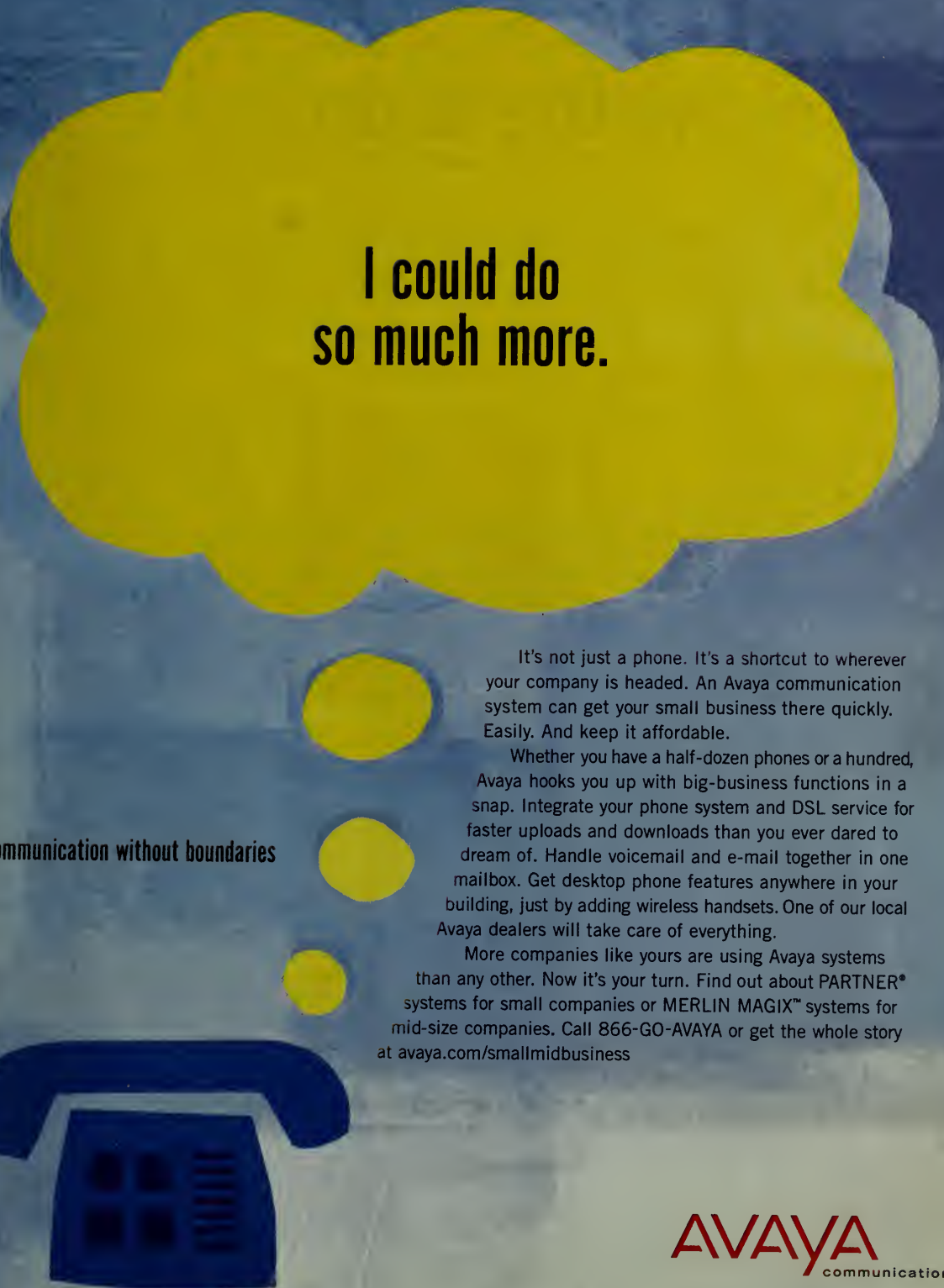
CASE IN POINT

Ken Smith was on eBay looking for dolls for his daughter. Instead, he hit the technology mother lode. An engineer with Equipe Communications Corp., an Acton (Mass.) startup with 100 employees, Smith stumbled across a brand-new Lucent telecom switch that lists for \$150,000. He got it for \$10,000. He also picked up a \$3,000 Cisco Systems Router for \$700. Both items came from failed technology companies. "It's a gold mine," Smith says.

RESOURCES

On the Web, digital-auction.com specializes in tech equipment; haggle.com auctions equipment, electronics, and furniture; and liquidation.com auctions bulk quantities of office furnishings and supplies. Liquidators also sell barely used merchandise. Liquidations Inc. (www.liquidationsinc.com) sells high-end office furniture, such as a \$3,000 Steelcase workstation for about \$1,500. For a comprehensive list of used office furniture wholesalers and retailers, see www.recycle.net.

—JOAN RAYMOND



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Evening the Score

WOMEN GET A BETTER SHOT AT LOAN APPROVAL **BY ROBIN D. SCHATZ**

EVERY WOMAN KNOWS she is more than mere numbers can convey—but how do you explain on a loan application form for your business that the reason your credit history is so “thin” is that everything was in your ex-husband’s name? Or that your income plunged because you quit work to care for a child? Or that even though your business is brand-new, you’ve got plenty of experience in your field?

In most cases, you can’t. The average lender will nix or approve your business loan based in large part on a computerized tally known as a credit score. According to a 2000 report by the Consumer Bankers Assn., 92% of major small-business lenders surveyed are already using credit scoring. The system analyzes how good a credit risk you are based on such factors as your income, how long you’ve been in business, and whether you’ve ever filed for bankruptcy.

The numbers certainly didn’t add up for Maria Morrissey, owner of the Celtic Clotheshorse in Austin, Tex., when she sought a loan for her kiltmaking business. First, the lenders said she hadn’t been in business long enough. Later, they told her she was “overextended” because of her credit-card debt. The bankers were unimpressed by her growing business, says Morrissey, who is booked through yearend with orders for her \$600 kilts. Recalls Morrissey: “I said, ‘Look, it works. Look at what I put in the bank. Don’t you care?’ And they said, ‘No, we just look at your credit score.’”

Nell Merlino, CEO of microlender Count Me In for Women’s Economic Independence, says such stories are common. “That credit scoring application, whether you’re looking for \$2,000 or \$25,000 or \$200,000, doesn’t take into account the totality of who we are.”

While Morrissey looked like a bad risk to the banks, Count Me In saw fit to lend her \$4,000. Was a loan officer moved to tears by the hard-luck story of this single mom, who had overcome ill-

ness and previous bankruptcy? Actually, no. A computer approved Morrissey’s loan based on her credit score.

Yup, you heard right. Rather than throw out a system that has made small business lending cheaper and more efficient, Count Me In has given the banker’s tool a mighty tweak. With backing from American Express Co. and advice from Fair, Isaac & Co., whose credit scoring system is used by nine of the top ten small-biz lenders, Merlino’s group devised its own scoring model, which poses some novel questions. For example, conventional scoring hurt new entrepreneurs—who include a growing number of women and mi-

norities—by requiring at least three years in business. “We don’t ask how long you’ve been in business,” says Merlino. “We ask how long have you been making your product/delivering your service. As a lender, you get a much more realistic picture that the applicant knows how to do what they say they do and can pay you back.”

For Nancy Dreier in Sutton, Mass., her work experience made up for her thin credit history and landed her a \$2,000 loan for her dog-grooming business. “It feels good to have someone who believes in you,” she says. Count Me In also asks if the woman has a business plan and if there are other entrepreneurs in the family who have helped her with two factors that worked in Morrissey’s favor.

This all sounds so humane—and so unbankerly—that the question naturally arises: Is it good business? That’s hard to say. The organization has made 125 loans since August and needs 2,000 transactions to analyze which questions predict a borrower’s success. It may turn out that Count Me In’s scoring system is just a noble experiment, but at least there are 125 grateful women who now know the numbers aren’t always stacked against them.

Schatz, an editor at Small Biz, can be reached at robin_schatz@businessweek.com

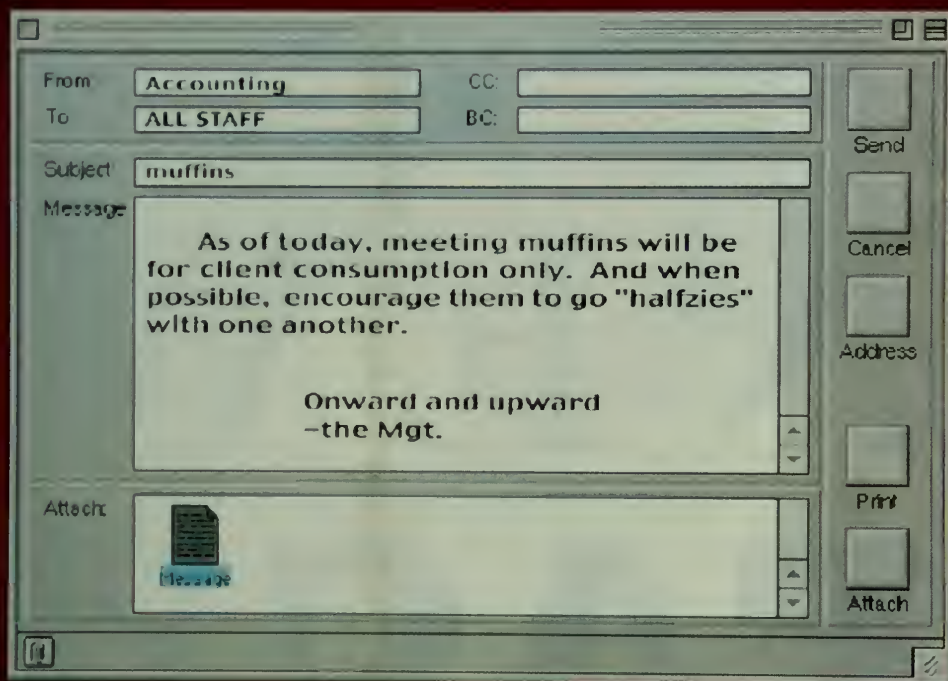


YOU'RE APPROVED:
Merlino has woman-friendly loan criteria

SCHATZ



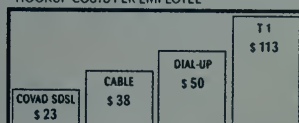
Credit
scoring
isn't a
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MENTION IMMIGRANTS and entrepreneurs in the same breath, and some people are more apt to think of a greengrocer or a restaurant owner than the likes of India-born Vani Kola. The 36-year-old engineer came to the U.S. as a college student in 1985 and sold her first U.S. company, RightWorks Corp., last year for \$667 million. And few people will picture someone like Ilya Talman, who emigrated to Chicago two decades ago from the Soviet Union and is now a card-carrying capitalist who owns a \$3.5 million tech recruiting firm. Colombian Yolanda Zambrano doesn't fit the stereotypes either. Since her arrival 10 years ago, she has transformed a piddly \$100,000-a-year travel-reservations office she purchased in Worcester, Mass., in 1992, into a \$5 million full-service travel agency.

Certainly the old ways are alive and well. Across the country, immigrants with entrepreneurial leanings are starting small retail or service businesses, just as they always have. But they have been joined by a new breed of foreign entrepreneurs: experienced professionals who arrive with not just skills but sometimes capital, too. The number of so-called investor visas, the L-1 visa issued to investor-entrepreneurs since 1970, has more than tripled over the past decade, from 14,342 in 1990 to 54,963 last year (chart, page SB20).

GLOBAL ELITE

ATTRACTED BY THE BOOMING economy of the '90s and a less regulated business environment than that of their home countries, these new immigrants have created companies that push aggressively into the business mainstream. "This is a fast-moving, highly educated, New Economy, global elite," says Frank Sharry, executive director of the Washington-based National Immigration Forum, a pro-immigration advocacy group.

Perhaps no immigrants have had a greater impact than newcomers from Asia, who have dramatically changed the face of the U.S. technology business. In Silicon Valley, for example, Indian or Chinese entrepreneurs have founded one in four tech companies since 1980, according to a 1999 study by Anna Lee Saxenian, professor of regional development at the University of California at Berkeley. And from 1995 to 1998 alone, they represented 29% of the startups. Their effect on the economy has been "nothing short of transformational," says Sharry. In 1998, these 2,775 Asian-owned companies generated \$16.8 billion in sales—17% of all sales from Silicon Valley's high-tech firms. And they employed more than 58,000 people, about 14% of all tech employees in the Valley.

While past generations of immigrants struggled for acceptance, the new immigrants fit more easily into an increasingly diverse, and accepting, America. Thanks in part to immigration laws that have become more liberal in the past 25 years, the influx of foreigners has soared to the

highest level in a century—about a million people a year. Today, one out of ten people in the U.S. is foreign-born and one out of every four is a person of color, according to the 2000 Census. "That dynamic makes it easier for immigrant entrepreneurs to put down roots and penetrate the market," says Robert L. Wallace, president of the BiTH Group Inc., a consulting firm in Columbia, Md.

Indeed, across the board, immigrants are more likely than native-born residents to become entrepreneurs. For instance, 11.6% of immigrant men and 7.2% of immigrant women had their own businesses, vs. 10.4% of native-born men and 5.6% of native-born women, according to a study of 1990 Census data—the most recent available that includes incorporated businesses—by Robert W. Fairlie, professor of economics at the University of California, Santa Cruz. That year, immigrants ran about 900,000 businesses, Fairlie says.

Why are immigrants more entrepreneurial than native-born residents? Demographics give one clue: More immigrants than native-born Americans fall into the prime age range for launching a business—25 to 44 (chart). At almost half of all immigrants—compared to a quarter of native-born Americans—live in urban centers where they have greater access to customers and markets. Then there's the personality factor. The very qualities that lead immigrants to leave home are common to entrepreneurs. Notes Stephen Moore, senior fellow at the libertarian Cato Institute in Washington: "They are self-selected on the basis of risk-taking, motivation, and ambition."

Certainly that's the case with Kola, Talman, Zambrano and the other entrepreneurs profiled below. What sets them apart is how they've managed to tap into their immigrant roots and perspectives to nourish and build their businesses.

A CAPITAL NETWORK

VANI KOLA

From: India

Age: 36

Company: NthOrbit, San Jose, Calif.

Business: Supply-chain software

Revenues: None; sold prior company for \$667 million

Employees: 6

VANI KOLA LEFT her native India in 1985 to study computer and electrical engineering at the University of Iowa. You'd think that by the time she tried to launch her first startup a decade later, her American degree and her work experience as an engineer in Minnesota would have been her calling cards. In fact, her American credentials made her just like

everyone else pitching high-tech businesses to venture capitalists in Silicon Valley and coming up dry. What finally put her over the top? Making the most of her Indian heritage and the powerful networking opportunity it afforded her.

Through her Indian connections, Kola heard about an influential networking group of South Asian entrepreneurs called The Indus Entrepreneurs (TIE) in San



Yolanda Zambrano WITH \$2,000 DOWN, SHE BUILT HER \$5.5 MILLION FIRM

business-to-business transactions. Kola says she found e's members were high-caliber people willing to give plenty of time—and apparently money: She raised more than \$3 million in seed funding from TIE investors. Zambrano's degree of tenacity and focus is among the best I've ever seen," says Suhas Patil, a veteran TIE member who mentored Kola and invested in RightWorks.

Thanks to that first round of funding, which helped build credibility with investors, Kola went on to raise more than \$60 million in venture funds. In the end, the payoff was huge. Last year, Kola sold RightWorks, a 350-employee, \$40 million company, to ICG for \$667 million. Kola declined to disclose her stake in the business.)

Clara, Calif. She pitched them her business plan for RightWorks, a company that would produce an e-commerce software product for

After the sale, Kola was ready to call it quits. "I had done what I wanted to do with the company," she says. "I had had all the travel and aggravation I could handle, and I thought, I'm never going to be a CEO again." But a few months later, after backpacking in Alaska and traveling with her two daughters to India, Kola was back in the Valley. Inspired by discussions with TIE members, she launched NthOrbit, which is developing software for supply-chain management. Some TIE members have even joined the NthOrbit management team.

Kola has shown her gratitude to this 5,000-member worldwide networking powerhouse by becoming a TIE mentor herself. "The biggest joy I get is in creating. And it's looking to the future that makes me a good entrepreneur."

TRAVELING TO THE TOP



YOLANDA ZAMBRANO

From: Colombia

Age: 37

Company: Alpha Travel Agency, Worcester, Mass.

Business: Travel agency specializing in Central and South America

Revenues: \$5.5 million

Employees: 7

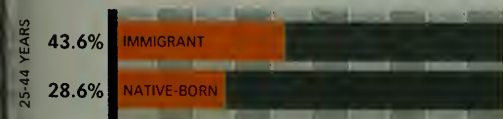
COLOMBIAN Yolanda Zambrano may be an accidental entrepreneur, but there is nothing haphazard about her efforts to build a thriving business that takes full marketing advantage of her own ethnic niche.

Zambrano, who had worked in a travel agency in Colombia and started studying accounting in college there, came to Worcester, Mass., as a newlywed in 1990. In the beginning, she spent most of her time learning English in the hopes of continuing her college studies. But two years later, she seized the chance to help out an acquaintance in a local travel reservations office. Just three weeks after that, the owner, a fellow Colombian, offered to sell her the business. Surprising herself, Zambrano took the bait. "I didn't have the money or the experience. I had never even thought about this," she says. "But then I thought, well, why not?"

Putting down a \$2,000 deposit with her husband, she agreed to pay an additional \$12,000 in installments. Zambrano could easily have followed the path of the previous owner—taking in reservations and then completing the transaction with a larger, licensed agency that could issue the tickets. But it wasn't long before Zambrano sensed the opportunity to use her bilingual advantage to turn this little \$100,000-a-year operation into something much bigger. Her goal: to offer travel packages to Latin America with everything from airline tickets to tours, hotel reservations, and money-transfer services. First, she had to scrape together \$20,000 to apply for a license as a full-service travel agency—by borrowing from her mother-in-law, maxing out her credit cards, and securing a small-bank loan. "I was awake till 3 a.m. every night for three months filling out the 50-page application form for the license,"

Age Appropriate

More immigrants than native-born are in the prime age range for starting a new business.



Source: U.S. Census Bureau

Zambrano says. "I just couldn't spare another \$5,000 to pay a lawyer to handle it."

Then, while she waited for the license, disaster struck: A big bilingual travel agency opened up across the street, siphoning off most of her business. But Zambrano, working solo, held on—just barely—thanks to a handful of loyal clients. Once she got her license, however, in November, 1994, Zambrano began to hire employees and she recaptured old customers by emphasizing her personalized service. To bring in new ones, she vigorously networked through local Hispanic organizations.

Within five years, Zambrano built Alpha Travel Agency into a thriving \$5.5 million business. She kicked off 2001 by winning the Small Business Administration Minority Enterprise Development Week Small Business Person of the Year award for New England. In April, she opened a new branch in Southbridge, Mass. What's next? Targeting African immigrants and African Americans, she has started offering travel packages and money-transfer services to Africa.

THE HOMETOWN ADVANTAGE



RASHID KHAN

From: Pakistan

Age: 48

Company: Ultimus, Cary, N.C.

Business: Software development

Revenues: \$6.1 million

Employees: 80

"I'VE ALWAYS HAD a sense of guilt towards Pakistan from being part of the brain drain," says Rashid Khan, who headed to Cambridge, Mass., in the 1970s to study computer science at Massachusetts Institute of Technology and chose to settle in the U.S., rather than put his skills to use at home. Now a successful entrepreneur, he doesn't feel guilty anymore, thanks to the strong ties he has forged with Pakistan.

Khan went on to earn two graduate degrees, including an MBA from Harvard Business School, and started two companies, including Boston-based Sintech Inc. in 1983, which he sold for \$5 million in 1988. Now,

Khan is running his second company, Ultimus Inc., which makes workflow-management software, from his North Carolina headquarters. But for product development Khan depends on his 35-person satellite office in his hometown of Rawalpindi, near the capital, Islamabad. "Ultimus today would not exist without the Pakistan office," he says. While Khan's software developers are paid competitively by Pakistani standards, he says he is reaping huge savings on labor costs, helping to make his company profitable and debt-free.

How is Pakistan benefiting—beyond the jobs Khan has created? Khan provides an internship program and intensive on-the-job training. "There's an excellent pool of talent there," Khan says. "They are like uncut diamonds."

THE LANGUAGE OF SUCCESS



ILYA TALMAN

From: Ukraine

Age: 46

Company: Roy Talman & Associates, Chicago

Business: Tech recruiting

Revenues: \$3.5 million

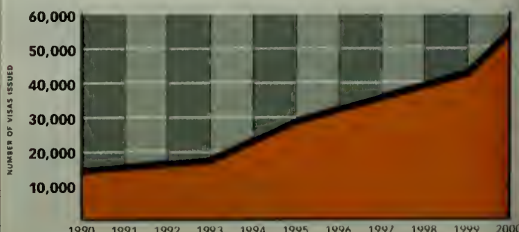
Employees: 22

WHEN SOVIET EMIGRÉ Ilya Roite man left his native Kiev and headed for Chicago in the 1970s, he wanted nothing more than to start a business and put Communism behind him. Like many immigrants before him, he tried to fit in by changing his name. When he became an entrepreneur, he split his last name in two and dubbed his company Roy Talman & Associates. "I changed the Telman part to Talman so I could say, 'It's Talman just like the bank,'"—the Chicago-based Talman Savings & Loan Assn. But he also would learn a valuable lesson of capitalism along the way: To succeed, a business must stand out from the crowd.

Talman earned his MBA at the University of Chicago. In 1982, while still a student, he and a partner launched a software business to computerize employment agencies' records. When customers didn't materialize, they used the software to launch their own recruiting firm, focusing on administrative staff. That business also languished. Next, on his own, he tried recruiting in technology—his real area of expertise. Finally, he could offer his clients something unique. The big payoff came in the late '90s, as the demand for tech professionals exploded. From 1998 to 2000 alone, Talman's revenues doubled.

BYO Capital

Growth in the number of L-1 visas issued to entrepreneur investors is accelerating.



Data: U.S. Department of State



ABDO SABBAN MOVING BEYOND HIS ARAB CLIENTELE MEANT FACING PREJUDICE

Washington area, Sabban expanded his sales force and his clientele. He hired a number of American brokers, who brought in American clients, although his personal clients are still mostly Arab. Sabban says he doesn't encounter prejudice anymore. Today, his brokerage serves U.S. senators and prominent businesspeople in Washington. Last year, his firm participated in the \$2.85 million sale of a Washington house to the Clintons. Just goes to show, even if an immigrant can't become President, there's nothing to stop him from doing business with one.

5 million. The recent tech downturn, he says, has been challenging," and his revenues are down 18% this quarter. But Talman isn't worried: "I still remember that sinking feeling in my stomach when I was trying to get out of the Soviet Union," he says. "After that, I'm not going to lose sleep over this."

POWER BROKER

ABDO G. SABBAN

From: Lebanon
Age: 49

Company: GS Realty, Washington

Business: Real estate brokerage and property management

Revenues: 1.5 million

Employees: Three full-timers, plus 14 temps

ABDO G. SABBAN, who fled war-torn Lebanon in the late 1970s, learned quickly that being an immigrant in America cuts both ways. When he arrived with \$250 in his pocket, his Arabic easily landed him a teaching job at Berlitz. Later, he brought Lebanese performers to the U.S. And in the late 1980s, when he finally fulfilled his goal of starting his own real estate business, he picked up an Arab clientele without

much sweat. But branching out beyond his ethnic community meant facing prejudice head-on. One prospective client told him he'd "never do business with an Arab."

Sabban never forgot that stinging comment, but it didn't stop him from pushing into the mainstream. "I knew I could be the master of my own destiny with my own business," he says.

In the '90s, as real estate development took off in the

ANGELS FROM ASIA



FRANCIS KHOO

From: Singapore

Age: 60

Company: Agaté Technologies, Cerritos, Calif.

Business: Mobile data-storage systems

Revenues: \$1.3 million

Employees: 11

RETIRED FROM A long career in investment banking at Bank of America and Lehman Brothers Inc. in Singapore, Francis Khoo had thought he would relax into the life of an angel investor. But things weren't working out at one of his companies, Agaté Technologies Inc., a Cerritos (Calif.) startup that was developing a portable hard drive.

The company had eaten through most of its cash, so Khoo called upon his extensive network of Asian investors to save the day. He managed to raise \$8 million in two months. But Khoo felt Agaté needed more than fresh capital—it also needed his business experience. So Khoo rolled up his sleeves, obtained an L-1 visa for investors, and moved to California to run the company. "This was a challenge I couldn't refuse," he says. Khoo's global vision was to join ideas and capital from Asia with Silicon Valley's dynamic tech environment. "It's a good combination," he adds.

Under his leadership, the company successfully launched the Qdrive, a tiny, portable hard drive the size of a door key, late last year. In the first three months of this year, Agaté sold 15,000 units. Agaté projects sales of 150,000 to 200,000 units by yearend through partnerships with companies such as Compaq Computer Corp. Will Khoo return to Singapore someday? Perhaps. He hopes to set up an Agaté office there in the future. For now, East and West are meeting in California.

@SB For more on visas for immigrants and advice for immigrant entrepreneurs, click Online Extras at smallbiz.businessweek.com



Holloway's only
choice was to hire
him — and he had
to fire several

Do You Dare Outsource Sales?

Why some companies are putting their fate in the hands of outsiders

BY KIMBERLY WEISUL

SAY SVEN HARMS IS FOND of outsourcing would be an understatement. The co-owner of Pioneer Research Inc. in Forestown, N.J., Harms believes his 45 employees should focus on one thing only: the design and marketing of binoculars and underwater cameras. So he lets outside contractors handle nearly all of his administrative and technology chores—from payroll and human resources to website hosting and development.

Harms has done more than hand off his back office. He outsources Pioneer Research's public face: its sales effort. The way Harms sees it, he doesn't have much choice. He wants his company to have national reach but can't afford to put his own people on the road. To cover the job effectively, he figures he would need at least 30 salespeople at an annual cost of about \$160,000 each, including

salaries, benefits, travel expenses, and sales incentives. Instead, Harms contracts with 20 independent sales firms, which give Pioneer Research some 60 people on the ground, helping to bring in annual sales of \$15 million. Outsourcing "was the only thing we could do," Harms says. "Revenues were small. Cash flows were small. Credit lines were small. We couldn't hire a lot of people."

Think of it as the final frontier of outsourcing. Small-business owners have long delegated onerous, behind-the-scenes tasks to outsiders in an effort to expand their companies while keeping payrolls small. Now, many are beginning to hand over what may be the single most critical front-office function—sales.

Would that make you nervous? It should. Outsourcing your sales force means that a customer's first contact

Birth of a Salesman

To find a reliable rep, ask the right questions

with your company could be with someone you've hardly met. You won't be able to tell your salespeople whom to visit or when. And you can forget about getting regular field reports. But for small companies with big aspirations, shifting sales onto someone else's shoulders can make sense. Many "rep" firms have worked in the same industry and territory for decades, providing instant access to customer relationships that could take years for you to build and cost hundreds of thousands of dollars.

The best part: Since reps work solely on commission, it won't cost you a dime to get started, and if it doesn't work out, you can fire them with a scant 30 days' notice.

As a group, they're often called "manufacturer's reps," but plenty will also represent service companies, and some specialize in cutting-edge industries where it can take months to close a single sale. The Manufacturers' Agents National Assn., a Laguna Hills (Calif.) trade group, estimates there are 25,000 rep firms nationwide, each representing an average of 10 companies and employing six people.

This is not your traditional outsourcing relationship. To succeed with a sales rep, you need to master a management style that's equal parts benign neglect and in-your-face meddling. Rep firms tend to be small, entrepreneurial outfits, often headed by someone who was once a top sales agent at a larger company. Like most entrepreneurs, they didn't go into business for themselves so someone else could tell them what to do. Then there's the loyalty issue—a rep's ties are often deepest with his customers, not the company whose product he sells. In fact, most successful reps have

worked for decades with the same customers, who have come to rely on the reps as trusted advisers who help sort among an ever-expanding array of products and services. While reputable companies won't sell products that compete directly with yours, many represent dozens of lines. It's up to you to keep on top of your reps and make sure your lines are front and center.

That's not always easy, says Derek Holloway, sales manager at Winco Inc., a \$6 million medical-equipment manufacturer

ASK CUSTOMERS: Which sales reps have they found most effective? Who provides the best customer service? Do any of them bad-mouth previous clients?

ASK OTHER CEOs: What rep firms do they use? Are any particularly good at developing new territory? Who gives the best feedback?

ASK PROSPECTIVE REPS: What do you know about our company and product line? How many other lines do you sell? Do they complement ours? Will we have the right to stop you from selling products that we perceive as competitors?

in Ocala, Fla., with 82 employees. Winco contracts sales out to 11 independent companies that collectively have salespeople selling Winco's wares to hospitals, doctor offices, and medical-equipment dealers. The cost to Winco: a commission of 9%. In a matter of months, one Winco's reps drummed up \$150,000 in new business in territory that had been stagnant. Holloway also has had fire less effective reps, one of whom went on to bad-mouth Winco to its customers. On balance, it beats switching to a full-time, salaried sales force, which would double or triple the company's sales cost—as long as you're vigilant. "A good rep will do magic for you," says Holloway. "A bad one will take your company down."

Keeping Tabs

KEITH SCHWARTZ KNOWS this all too well. His Euclid (Ohio) company, On Target Promotions, is recovering from a disastrous outsourcing experience. Last year, the \$3 million, four-person company, which markets ties, belts and scarves to food stores and drugstores, hired a rep firm to cover an East Coast supermarket chain. The account generated sales of \$100,000 a year, but by having someone on the ground, Schwartz expected that sum to double. Instead, the rep firm blew the account, generating only a few orders ahead of last Father's Day, and no order at all for the crucial Christmas season. "Today, we're fighting just to get back in," Schwartz says.

While Schwartz wishes he had kept better tabs on his reps, most sales reps say that meddling managers are the biggest problem. Tom Searcy, chief executive of Accelerator Inc., an Indianapolis rep firm that sells call-center services for six companies, recalls one client who checked in twice a day for reports—even though it typically took three months to close a sale. "They were very anxious to know exactly what was going on," says Searcy. "But in reality, they lost that luxury when they outsourced."

That means you have to be extremely careful when selecting your rep firm. Make sure the other companies they represent complement, rather than compete with

Off the Top

A sample of the commission on net sales you're likely to pay sales reps, by industry

ADVERTISING	25%
INDUSTRIAL SUPPLIES	16%
CONSTRUCTION SERVICES	14%
SOFTWARE	13%
TELECOM EQUIPMENT	11%
JEWELRY	7%
COMPUTERS	5%
TOYS AND GIFTS	4%



ur business. Ask a potential rep to provide you with a marketing plan, complete with detailed sales projections. At those numbers in your contract, and use them as benchmarks. Once you've made a selection, make sure you have the infrastructure to support your new sales force. Requests for information from customers might go from 10 to 45 a day," says Miller. "If you can't provide that, the reps are going to lose confidence in you." So will the customer.

Smart managers also demand a fair amount of feedback, even if it isn't the blow-by-blow account of an in-house rep. "If my phone's not ringing, if I don't get faxes, if I don't have contact over a week or two, I know things are not percolating," says Winco's Holloway. He expects to see progress within 60 days of hiring a rep, whether it comes in the form of actual sales or detailed reports of what customers want or are saying about Winco. Big month-to-month sales fluctuations are another possible sign of trouble. Unless your business is very seasonal, it could mean the rep isn't working the territory consistently—what Holloway calls "crank and coast." At the beginning of each year, Holloway asks for quarterly sales forecasts—and he holds the reps to them.

Finally, just because you've chosen to outsource, it doesn't mean your responsibility for sales is over. This is not handing over your accounting chores. Judi Flowers and

Greta Longmire, co-founders of Bonjour Fleurette, a Sausalito (Calif.) manufacturer of high-end women's slippers with 25 employees, will sign their sixth rep this month. While Flowers and Longmire will handle large department-store clients, like Saks Fifth Avenue and Neiman Marcus, the reps will give them access to hundreds of small, independent boutiques. During the past four months, Flowers and Longmire have brought in about \$75,000 in orders. With the reps working trade shows and selling to boutiques, they're hoping for revenues of \$500,000 in their first full year.

The two will still spend plenty of time on the road themselves. Doesn't that defeat the purpose? Not necessarily. Reps in the fashion industry often have showrooms, and Flowers once walked into one only to see her company's slippers tossed haphazardly on the floor. Dismayed, she quickly arranged them into an attractive display, using an antique mirror and a scattering of the colorful, custom-made silk flowers the company uses to adorn its footwear. "You can't let these people just go off on their own," says Flowers. "You have to stay involved." Your sales may be outsourced and out of sight, but they shouldn't be out of mind.

@SB For more on outsourcing your sales force, click Online Extras at smallbiz.businessweek.com

TEAM EFFORT: Bonjour Fleurette's Longmire and Flowers use reps, but also do much of the heavy lifting

AT A GLANCE

WHO: Kimberly Schlegel, 24**COMPANY:** RSVP-Soirée,
Dallas, Texas**REVENUES:** \$400,000**EMPLOYEES:** 8 full-time and
3 part-time**CONCEPT:** A high-end
event rental and party
planning service**PRIOR EXPERIENCE:** Lots
of partying

It's My Party

For Kimberly Schlegel, having fun is serious business. So serious that the 24-year-old Dallas socialite turned her favorite hobby—partying—into a money-making venture.

It happened almost by accident. When Schlegel was organizing her own social debut party two years ago, her family had to buy every last item for the 600-guest affair. When it was over, the debutante realized she had a ready-made inventory. The upshot: RSVP-Soirée, an upscale event rental business and one-stop party shop. Whether it's a cozy brunch for two or a swanky shindig for 2,000, Schlegel can furnish everything from calligraphy place cards to Grecian statue vases to silver-beaded dessert plates. She'll even send out invitations and manage the replies. And her online social events calendar is helping put her in the center of Dallas' social swirl. "I love making people have fun," says Schlegel, who hopes to do \$1 million in sales next year and open two more outlets in Dallas before hitting Atlanta and New York. *Seems like the party has just begun.* —NAWEEN A. MANGI



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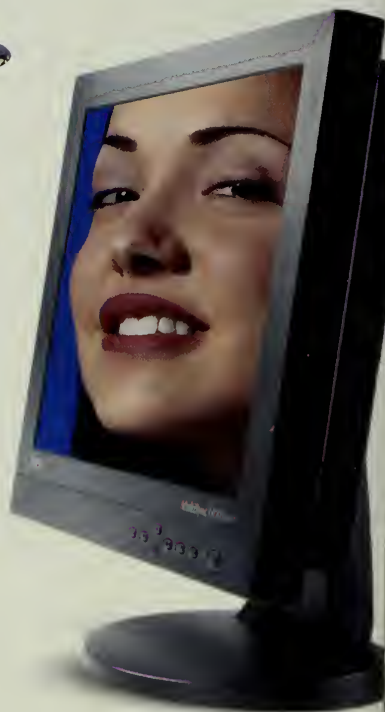
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INFORMATION TECHNOLOGY

ANNUAL REPORT

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As the downturn bites, more companies are judging info tech investments on the basis of how much money they can save

BY PETER BURROWS

Just six months ago, the top brass at retailer Staples Inc. had clear marching orders for its tech staff: Buy computer gear by the boatload so the company could launch new e-businesses such as its Staples.com Web site. Like executives in every other industry, from autos to real estate, Staples bosses were determined not to eat the dust of dot-com or bricks-to-clicks rivals. So Max Ward, vice-president for technology, spent \$125 million loading up on computers, software, and networking gear to build Staples into an e-commerce heavyweight. Ward didn't fret about whether Staples was squeezing every last bit of oomph out of the equipment he was installing.

Not anymore. Staples is feeling the brunt of the downturn, and Ward has new marching orders: Find the oomph. While Staples is folding its Staples.com e-commerce subsidiary back into the company, it's not backing off technology to reach out to customers and make itself more efficient. Ward is installing technology for an online help desk where store managers and clerks can go for handy answers. He typically aims for a 17% return over four years on his tech investments, but the online help desk could boast a 60% return. He expects to save \$10 million through a \$2.5 million investment in a better way of storing data. "Prior to this year, 85% of our tech spending was to drive business growth," says Ward. "Now, 40% is for things that will lower our costs. We want the most bang for the buck."

With Internet exuberance barely cold in the grave, a far more sobering period has arrived: the era of efficiency. The days of free spending on technology and wide-eyed optimism about the Internet

have given way to clenched pocketbooks and pure pragmatism. Suddenly, today's executives are no longer asking about technology that will help them launch new businesses but about gear that will cut costs and wring more efficiency out of workers. "We're leaving an era in which incremental improvements were pooh-poohed as a waste of time, like trying to improve the buggy whip," says Geoffrey A. Moore, managing director of Chasm Group LLC, a Silicon Valley consultancy. "Well, it turns out the buggy whip isn't quite done yet. And there's a

maker Siebel Systems Inc. nabbed No. 14 spot because its sophisticated software helps companies better cater to customers.

As for the Internet revolution they are MIA. Gone from the Info 100 is Web portal Yahoo!, e-commerce pioneer BroadVision, and start Vignette, whose technology ages millions of Web pages on the fly. Even the Big Three—AOL Time Warner, Amazon.com, and eBay—couldn't make either enough profits or enough investor confidence to make the grade. "I

THE ERA

heck of a great business in helping customers be more efficient."

For evidence of this, one need look no farther than *BusinessWeek's* fourth annual ranking of the 100 best-performing technology companies in the world. The Class of 2001 is dominated by companies that have either achieved the efficiency long promised by the technology revolution or that sell products and services to help others improve their bottom line. Topping the list is unsung Celestica Inc., a contract manufacturer that churns out big earnings despite a 3.7% operating margin—so thin it's scary. IBM, whose slow growth made it a no-show last year, came in at No. 6—thanks to big demand for its consultants, who demystify and make the most out of tech gear. And software

gone from category killers to cost-cutters," says Hal Varian, dean of the School of Information Management Systems at the University of California at Berkeley.

In the end, however, the cost-cutters may be the real heroes of the Internet Revolution. As companies demand more ways to streamline and reduce expenses, they will increasingly turn to the Net for cheap communications. The bone for everything from buying ballpoint pens to managing complex supply chains, spans scores of countries. The transformative nature of the Internet was not in online banner ads or auctions of Babies. Instead, the big bang was being able instantly and effortlessly to work as one with employees, suppliers,

OF

EFFICIENCY



Now, customers want to absorb the technology they already have

ers, partners, and customers—all over the Web.

Lured by that promise, in the past five years, thousands of corporate technology czars went on buying binges. As enthusiasm for the Internet reached a crescendo, companies snapped up servers, software, routers, fiber optics—anything they thought would arm them for an Internet future. Between 1996 and 2000, companies invested \$1.7 trillion in technology—nearly double the amount spent in the previous five years, according to the U.S. Bureau of Economic Analysis.

MICROSCOPE. Now customers want to absorb the technology they already have and put it to better use before gobbling up more. A peek into Schneider Logistics, a Green Bay (Wis.) company that moves supplies and materials for the likes of General Motors Corp., highlights the problem. Schneider has the technology in place to handle all its orders electronically. That means if GM is depending on Schneider to get it even something as mundane as 20,000 napkins by Tuesday, it can use the Net to reach the supplier instantly, order the napkins, and arrange warehousing and delivery. Yet only 70% of Schneider's transactions are handled online. The problem: Suppliers need training on how to use the Web. Chief Information Officer Steve Matheys says that once 95% of Schneider's orders are handled electronically, it will give the company a 10% to 20% productivity boost. "We have all the technology we need, but the processes have to be worked through to get the business opportunity," says Matheys.

This isn't the first time that technology buying has outpaced the process of putting it to good use. In 1985, after

five years of runaway growth, the PC market skidded to a stop as companies realized the productivity gains just had not materialized. It wasn't until the early 1990s, after thousands of companies had worked through the complexities of local-area networks and e-mail, that the payback came. The lesson: It takes time for customers to apply technology. And the more binge buying that takes place, the more protracted the period for digesting it.

Indeed, the economic slowdown has forced many companies to turn the microscope on tech spending. In a May survey of 260 chief information officers conducted by Deutsche Banc Alex. Brown and *CIO Magazine*, the planned growth for the next 12 months in tech budgets fell to 4%, down from 19% last November. So what projects are top priorities? Some 70% say Net technology is critical, according to a June survey of 150 senior execs by consultant DiamondCluster International and the Wharton School of the University of Pennsylvania. Of those surveyed, 46% say that using the Net for customer service will be a boost, while 48% say that they can get benefits from wiring their purchasing. What's not so hot? A May survey of 225 corporate CIOs by Morgan Stanley Dean Witter & Co. showed that the areas most likely to be cut are consulting and new custom application development. Translation: Corporate bigwigs



don't want big, complex, and expensive computing systems.

The tech companies that will prosper the most are those that have figured out both halves of the efficiency game: how to live it by the way they do business internally and how to sell through profit-boosting products and services. There's no bigger discipline than Toronto's Celestica. The company's revenues have ballooned from

OILING THE CORPORATE MACHINE

Today's top companies are those that keep a close eye on costs and don't waste effort—and those that sell products or services that help their customers do the same.

HOW TO BE EFFICIENT YOURSELF

HAND OFF WHAT YOU DON'T KNOW

High-flying Nvidia relies on semiconductor makers to build the speedy graphics chips. Sun Microsystems outsourced much of its manufacturing, saving \$300 million.

LET CUSTOMERS HELP THEMSELVES

Companies can save a bundle on customer service by letting clients get help online. Last year, IBM eliminated 99 million calls to telephone help desks and sales reps by offering support information to customers on the Web. That helped Big Blue avoid \$2 billion in costs.

FOCUS ON PROCESS

PC giant Dell knows that time is money and that inventory is the enemy. By making a religion out of processing orders rapidly, streamlining production, and getting goods to customers fast, Dell can keep just five days of inventory on hand.

TIGHTEN THE SUPPLY CHAIN

Server maker Sun Microsystems has designed software that alerts it when contract manufacturers have too many parts to build Sun's machines—one reason Sun hasn't had to write off inventory as sales have

and put it to better use before gobbling up more



lestica banks on technology. Three years ago, the company pumped \$60 million into new computer systems, including supply-chain and database software to handle the \$8 billion worth of parts that the company bought in 2000 for its plants, located in 12 countries.

That proved a lifesaver when the tech industry went into reverse last fall. While orders fell roughly \$700 million as the slowdown hit Celestica's customers in the March quarter, inventory rose by only \$300 million. The company avoided \$400 million in additional in-

CELESTICA

1 Eugene Polistuk, Chairman and CEO

Celestica was the hottest of the hot. Sales of the contract manufacturer ballooned 84%, to \$9.8 billion, as companies sent huge manufacturing jobs its way. And thanks to superb operations, profits grew 147%, to \$305 million. Now, Polistuk is promising to hit \$20 billion in sales by 2003—downturn or no.

billion in 1998 to \$9.8 billion last year. Having expanded from 15 plants in 1998 to 36, it now builds everything from Motorola cell phones to Sun Microsystems servers far more quickly, reliably, and cheaply than those companies could do themselves. How does Celestica do it? For starters, it boasts a lean management structure. Only 3.5% of Celestica's workforce is in management. Instead, Ce-

lestica's plants are wired to provide critical. Celestica keeps one huge database of parts it buys so that each plant manager can see what other plants have, so they can find a home for excess parts. And if that doesn't take care of the glut, a supply-chain SWAT team at headquarters sees it in real time and can use the company's huge buying power to get suppliers to roll back on orders. "I can see almost in-

stantly whether another plant has the inventory," says Andrew G. Gort, Celestica's executive vice-president for global supply-chain management.

Examples like this are prompting companies to turn over the jobs they can't do cheaply themselves. Despite slowing sales, Sun Microsystems Inc. ranked No. 65 on the Info Tech 100, in part because it has kept costs down by outsourcing the manufacture of its low-margin products to Celestica and others. For Sun to build a 1.1 million-square-foot factory to manufacture workstations and servers would cost \$350 million in capital expenses and another \$300 million a year to operate, says Marissa Peterson, operations chief at Sun.

OUTSOURCER'S APPRENTICE. That's why our list is chock-full of outsourcing companies—from contract manufacturers Samina Corp. (No. 12) to chip foundry United Microelectronics (No. 8) to payroll processor Automatic Data Processing (No. 46). All are prospering through a laser focus on jobs their customers typically consider scut work.

To compile our IT 100 list, *BusinessWeek* started with financial data from Standard & Poor's Compustat, a division of The McGraw-Hill Companies that has compiled data on 10,000 publicly traded companies. From this universe, we cull our tech leaders and then add non-U.S. companies suggested by our network of foreign correspondents. To make our final cut, companies are measured by four criteria given equal weight: revenue growth, total size, shareholder return, and return on equity.

Downturns, as it turns out, can be upturns for outsourcers. "This is the best of times because no one ever wants to do their own manufacturing again," says Michael E. Marks, CEO of contract manufacturer Flextronics International Ltd. (No. 25). Marks says Flextronics' best year in the past decade was 1992, the year after a tech slowdown. "2002 is going to be just a huge year for our industry."

How do contract manufacturers make money on the tasks that bleed others dry? Since they live and die on tiny margins, they go to great lengths for every ounce of efficiency—say, to invest in a \$1 million vibration chamber for making sure industrial gear can take a good shaking. Such equipment can help the contract manufacturer meet its customers' marketing promises and avoid costly returns in case the gear

WHO WINS SELLING EFFICIENCY

CONTRACT MANUFACTURERS Because they can save tech firms gobs of time and money, contract manufacturers are having a field day. Six of the top 25 on our list—including Celestica—make gear for others.

TECHNICAL SUPPORT AGENCIES Having binged on servers, software, and networking gear during the Internet boom, companies are now paying experts such as IBM, Cap Gemini to show them how to make those investments pay off.

SOFTWARE DEVELOPERS Forget gee whiz e-commerce software designed to revolutionize the way business is done. Now, old-guard software makers like PeopleSoft and SAP are prospering as companies buy programs that help them manage their operations.

WEB HOSTING PROVIDERS As the number of Web pages piles up, companies need more efficient ways to store and manage information. That's why hosting providers such as EMC and Brocade still get paid a hefty margin for their gear.

Some old-tech specialists are going gangbusters. Right now, customers can't get enough of IBM's services

isn't up to snuff. While the computer maker would never be able to get a return on investment, contract manufacturers get a payback in short order. The reason: The computer maker might use the machine only 5% of the time, but the contract manufacturer could keep it humming 30% of the day as it cranks through products for many different companies, says Pam Gordon, president of market analyst Technology Forecasters.

On the flip side of that efficiency equation are the companies that outsource as much as possible. Perhaps no seller of technology hardware has latched on to this as much as Juniper Networks Inc. (No. 56). Nearly all the 1,300 employees at Juniper's Sunnyvale (Calif.) offices either design or sell the company's Internet routers—nothing else. The company outsources everything from payroll to the production of its high-speed networking gear. The glue that holds all these outsourced tasks together is the Internet, where Juniper can stay in constant touch with the work being done. "There's a lot of information we get that is of a real-time nature, where quick decisions need to be taken," says Pradeep Sindu, chief technical officer. "That's why the Internet is being used. It allows you

to do things much more efficiently."

Mastering the art of being a "virtual" company has made Juniper a productivity champ. Its sales per employee were \$615,000 last year, compared with an average of \$258,000 for the communications sector. And it has helped Juniper wrest 30% of the router market from powerhouse Cisco Systems Inc. over the past three years—and earn an impressive \$16.7 billion market valuation from Wall Street.

Just leaving the driving to others doesn't assure success. Networking giant Cisco Systems relies on others to do most of its manufacturing, yet it slipped from No. 25 on the IT 100 list last year to No. 155 this time around. The company failed to spot a sudden decline in orders and ended up having to write off \$2.2 billion in inventory and lay off 14% of its staff.

"FOR REAL" Technology companies that can help their customers avoid ending up like Cisco have plenty to do these days. That's everybody from Web-smart consultants to cutting-edge chip designers to sellers of network storage devices that can help customers warehouse their bits of corporate information more efficiently. Software makers such as Siebel, SAP (No. 30) and PeopleSoft (No. 33) make software that helps com-

THE LEADING PUBLIC INFO TECH 100 COMPANIES

- 1 Celestica
- 2 Verizon Communication
- 3 Scientific-Atlanta
- 4 Nvidia
- 5 China Mobile (Hong Kong)
- 6 IBM
- 7 Telefónica Móviles
- 8 United Microelectronics
- 9 América Móvil
- 10 Check Point Software

RANKED BY PERFORMANCE

panies move quickly and control co

We're not talking small change. Oracle-Palmolive Co. saved \$430 million by installing SAP corporate software managing its financial accounts and planning throughout its worldwide operations. The bulk of the savings, \$280 million, came from consolidating 80 data centers scattered around the world into one highly efficient one in New Jersey. Smarter software helped, too. Last year alone, the company trimmed its inventories by 13%, saving \$150 million, and improvements to its planning system. The software allows the company to attach its ordering system directly to thousands of cash registers at Wal-Mart Stores Inc. and Kmart. It can monitor sales right up to the minute and quickly adjust its production plans. That



IBM

6 Louis V. Gerstner Jr., CEO
Overlooked during the dot-com craze, Big Blue is back and stronger than ever. IBM's gargantuan size and profits have pushed it to the top tier of the Info Tech 100 list, but generating strong growth is still its challenge.



Because he has new Office XP, today he can alter space and time itself. He will come up with an idea in an hour, and won't spend an entire day making it into a presentation. He won't spend precious hours mining the menus for options, struggling with formatting or wandering through the server in search of files. Everything he needs is on the screen, next to his work. And as for space, if this idea doesn't merit a bigger office, nothing will.

Microsoft® Office XP, with time-saving Task Panes which present the tools you need that were previously hidden in the menus. Just one of many improvements in this, the new version of Microsoft Office.

You want it. You need it. Now you can get it.



Microsoft

Office^{XP}

Experience it for yourself at microsoft.com/office

Microsoft®

Being a productivity champ has helped Juniper wrest 30% of the router business from powerhouse Cisco



JUNIPER NETWORKS

56 Scott Kriens,
Chairman,
President, and CEO

Juniper is the picture of efficiency. The maker of networking gear outsources all of its manufacturing and uses the Internet to stay in touch with suppliers and customers. That's why it has gross margins of 65%, compared with an industry average of 46%.

the company is able to predict demand accurately 98% of the time and ship just the products the stores can sell. "This enterprise software isn't hype," says Forrester Research analyst Charles Homs, who studied Colgate-Palmolive. "This will not die. This is for real."

While demand is slowing for PCs and computer servers that run Web sites, there's plenty of business for some spe-

cialty hardware makers that enable companies to lower their costs. For instance, many companies now spend 70% of their hardware budget on so-called storage area networks—systems that link storage devices together—up from 30% a few years ago. That provides a boost for Brocade Communications Systems (No. 59), which sells a storage switch that lets companies make do with far fewer disk drives. While the slowdown will prevent Brocade from repeating its 379% sales growth in 2000, the pain won't be too great. Merrill Lynch & Co. expects the company to grow 58% in 2001. Says Staples CIO Brian T. Light. "Storage is like candy. You just can't get enough of it."

FULL MENU. In information-technology services, big is back. Past highfliers such as Exodus or Viant that specialized in one service—say, hosting Web sites or offering advice about the Internet—have fallen off our list. Yet old tech specialists such as EDS (No. 48) and IBM are going gangbusters. That's because they offer corporate clients the full menu of services, including the consulting expertise, software products, and giant data centers from which they can run outsourced tasks. Customers can't seem to get enough of IBM's services. In the first quarter of this year, IBM signed \$10.2 billion in information technology service deals—up from \$8 billion a year ago. "When economic conditions drive

business to be more efficient, service help them reduce costs," Chairman Louis V. Gerstner Jr. told analysts last month. "A lot of those services offer look pretty good right now."

Bottom line: The tech elite are busy in making good use of what they sell. Siebel Systems CEO Thomas Siebel's fanatical devotion to using his own software for managing customer relationships appears to have paid off. He can analyze the status of deals the way down to the individual salesperson because they are required to enter all information, everything from conversations with customers to the figures they're quoting during contract negotiations. The company has a measure stick to match up sales goals with what's actually happening in the field and quickly step in when something goes amiss.

Last quarter, the CEO saw sales slipping down just five weeks into the quarter. He knew that with expenses growing it was going to be tough to meet Wall Street's expectations. So he cut off 10% of his workforce, curtailed executive bonuses, and cut expenses within 30 days. In the end, the company was able to meet both expectations. First-quarter revenue was \$588.7 million, up 87% year over year, while income was \$76.9 million, up 118%. "I know exactly what is happening," Siebel. "I may not like what I see, but I know what is happening."

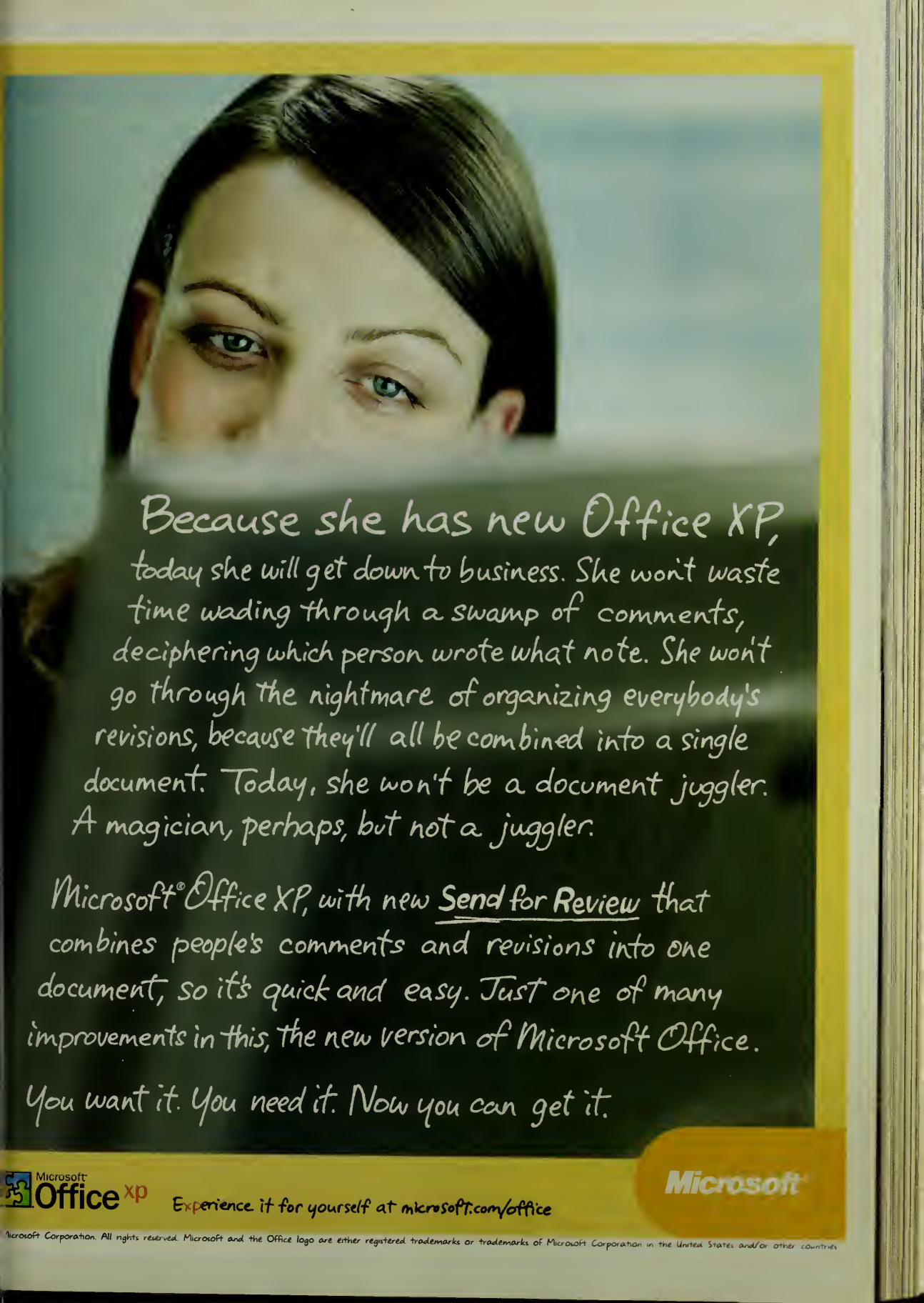
In the post-Net boom era, two things will become clear: Selling efficiently is good, being efficient is better, and both are the new recipe for success.

With Ira Sager and Steve Hamer
New York and bureau reports

THE LEADING PRIVATE INFO TECH 100 COMPANIES

- 1 Accenture
- 2 Seagate
- 3 SAIC
- 4 Graybar Electric
- 5 Synnex
- 6 Bloomberg
- 7 DynCorp.
- 8 Kingston Technology
- 9 Comark
- 10 SHI

RANKED BY REVENUES



Because she has new Office XP,
today she will get down to business. She won't waste
time wading through a swamp of comments,
deciphering which person wrote what note. She won't
go through the nightmare of organizing everybody's
revisions, because they'll all be combined into a single
document. Today, she won't be a document juggler.
A magician, perhaps, but not a juggler.

Microsoft® Office XP, with new Send for Review that
combines people's comments and revisions into one
document, so it's quick and easy. Just one of many
improvements in this, the new version of Microsoft Office.

You want it. You need it. Now you can get it.



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SCIENTIFIC-ATLANTA

3 James McDonald, CEO

Despite naysayers, Scientific Atlanta bet its future on the rise of digital cable TV and won big. Now it's a premier provider of digital set-top boxes and is fending off satellite TV by offering two-way communications for shopping and game playing.

special effects video gamers love. Check Point Software Technologies Inc., No. 10, dominates the market for called firewall software that protects Web sites from intruders.

These companies were far from overnight sensations. Rather than sue the false promise of instant e-commerce riches, they quietly plugged away for years, nurturing market segments that could continue to grow even in an Internet downturn. Now niche players are bubbling to the top with polished products and workable business plans that can weather the storm.

FOCUS FIRST. How do the best niche players do it? It pays to spot a market first. Successful niche players must constantly out-innovate the competition as giant companies start to move into them. The smart ones form relationships with strategic partners that can complement their core abilities. And most importantly, they keep their focus, even when they grow rapidly. "We're not going to worse-ify," says David E. Maguire, CEO of Kemet Electronics Corp., No. 38 on the list. Its sales grew 71% last year, to \$1 billion, as the company sold billion-dollar one thing—the tiny capacitors that control the flow of electricity in everything from cell phones to rocket ships.

Often, when a new market is emerging, a lot of people notice it. So the smart thing is to figure out what's going to be the valuable piece of the business over the long haul. That's what Kemet Communications Systems did years ago when it entered the now growing field for so-called "storage

LITTLE NICHESTHAT GREW

A combination of focus and expertise can mean big money from narrow markets

A decade ago, James McDonald was considered a dreamer when he predicted cable companies would soon offer digital movies on demand and push-button shopping from living rooms. Yet McDonald, chief executive of cable set-top box maker Scientific-Atlanta, never gave up—even after his first interactive TV cable box flopped in a 1993 test in Orlando. The boxes cost \$5,000 apiece to produce, and consumers weren't clamoring for their i-TV. "The cable operators were about to give up on us," McDonald admits.

Last year, McDonald's foresight and patience finally paid off. Cable providers were desperate to fend off competition from satellite systems like DirecTV. Meanwhile, Scientific-Atlanta had fine-tuned its digital box, packing it with dozens of interactive features such as e-

mail and e-commerce, and bringing the price down to \$300. Today Scientific-Atlanta supplies 52 of the 100 largest cable-TV systems with digital boxes. In the most recent quarter, the company's sales surged 51%, to \$663.7 million, and earnings doubled, to \$76.2 million.

Scientific-Atlanta—No. 3 on *BusinessWeek's* Info Tech 100—is one of a dozen or so midsize companies on the list that struck gold by conquering a niche market. Other standouts: No. 4 Nvidia Corp. is tops in the market for graphics chips that create the realistic

NVIDIA

4 It has gained market share from rival ATI Technologies by making graphics chips that help PCs and Macs run the hottest, fastest games. Now it's expanding into a new niche—providing chips for Microsoft's Xbox game console.

KEMET ELECTRONICS

38 By focusing on the two most popular varieties of capacitors, which regulate the flow of electricity on everything from cell phones to the Patriot missile, Kemet won the business of the world's 300 electronics makers.

ks"—systems that link multiple stor-
 devices. Rivals built storage "hubs,"
 which steer data between computers
 and preselected storage machines. Bro-
 cade created a new kind of "switch,"
 which can intelligently determine the
 place for each chunk of data to be
 stored. Brocade chose right. It's No. 59
 on our list, with sales nearly doubling,
 to \$115.2 million, last quarter. "To the
 technically lazy, hubs were the obvious
 choice. We tried to take a longer view,"
 says Brocade CEO Greg Reyes.

LENGTH MOVES. The trick for niche
 players is figuring out when and how to
 expand. When the niche champs size up
 potential new markets, they look for con-
 ditions that play to their strengths. Once
 Intel had mastered the art of creating
 microchips for PCs, it built on the
 core technology to create chips for
 laptop and workstation markets.
 Then the company expanded into making
 microchips for video-game consoles,
 signing a contract for Microsoft Corp.'s
 upcoming Xbox. Revenues surged 62% in
 the most recent quarter, to \$240.9 million.
 Not all adjacent markets that seem
 promising pan out. Analog Devices Inc.,
 No. 4 on our list, a specialist in chips
 for handling audio and video communi-
 cations, branched into chips for the disk-
 drive business about eight years ago.
 When it discovered that the pricing pres-
 sure was too intense to yield the profit
 margins it had come to expect, the
 company bailed four years later.

Another pitfall: trying to pack too
 much into a product. Nvidia's first chip,
 introduced in 1995, was more than a year
 and jammed with so many extraneous
 features that it didn't perform well.
 The company started over, focusing on
 rendering the two-dimensional and three-
 dimensional graphics that designers and
 gamers crave. The lesson: "Do fewer
 things really well, focus, and don't try to
 compete on the world," says Nvidia CEO Jen-
 Hsun Huang. With the right game plan,
 you can make it big after all.

*Arlene Weintraub in Los Angeles,
 Charles Haddad in Atlanta,
 John Edwards in San Mateo, Calif.,
 and Geoff Smith in Boston*

COMMUNICATIONS SYSTEMS

The economic slowdown has
 barely dented the market for
 storage devices that are linked,
 and Brocade's switches help
 track a flood of data without
 a hiccup. The result: Sales nearly
 doubled to \$115 million, last quarter.

RED-HOT IN FIREWALLS

Check Point makes a fortune selling security software

Most people would probably guess
 that software giant Microsoft
 Corp. has the richest profit mar-
 gins in the industry. They'd be wrong.
 The winner of this contest is little-
 known Check Point Software Technol-
 ogies Ltd., the leader in making soft-
 ware that protects Web sites from
 hackers. It has an enviable 52% operat-
 ing margin, compared with Mi-
 crosoft's 45%. And seven-year-old
 Check Point, No. 10
 on this year's Info
 Tech 100 list, is no
 small fry. It made a
 \$221 million profit
 on \$425 million in
 revenues last year.

There are two
 reasons Check
 Point has turned
 into a cash ma-
 chine. First, though
 it has an American
 headquarters in
 Redwood City,
 Calif., it does most
 of its development
 in Tel Aviv, Israel,
 where the cost of
 doing business is
 60% of what it is in
 the U.S. Second,
 Check Point has
 only a skeleton
 sales and market-
 ing team. It relies
 on a network of
 1,000 resellers

who do most of the sales and market-
 ing on its behalf. "By creating those
 channels, they're essentially just a
 pure software company," says analyst
 Chuck Jones of Salomon Smith Barney.

Check Point has something else go-
 ing for it. The company focuses on do-
 ing just a couple of things really well.
 Its main product is a firewall, which
 keeps hackers from breaking into cor-
 porate computer networks. It also pro-
 duces so-called virtual private network
 (VPN) software, which allows companies
 to send information across the public
 Internet but protect it every step of
 the way with encryption technology.
 These are good businesses to be in. The
 market for firewall software, which was
 about \$800 million last year, is expected

to grow 25% a year for the next three
 years. The VPN market, which was \$500
 million last year, is forecast to grow
 33% a year, according to UBS Warburg.

While other security companies cre-
 ate sweeping sets of products, Check
 Point has stuck to its niches. CEO Gil
 Shwed believes there's no need to
 stray because there's still plenty of un-

tapped potential in
 his markets. "At
 the end of the day,
 the demand for In-
 ternet connectivity
 is still growing," he
 says. "And corpora-
 tions will always
 need security."

Sales of security
 software have held
 up better than other
 categories be-
 cause this stuff
 helps companies
 save money. Two
 years ago, real es-
 tate manager Equi-
 ty Residential
 Properties Trust
 was spending
 \$35,000 a month to
 connect remote of-
 fices to its head-
 quarters in Chica-
 go. By moving that
 communication onto
 the Net and in-
 stallating Check
 Point's VPN soft-
 ware, those costs
 dropped to \$5,000 a

month. "It made me a big hero around
 here," says John Shelest, senior net-
 work engineer in charge of the project.

Check Point can't afford to relax.
 Although it dominates the firewall
 and VPN markets with a 41% and 52%
 share respectively, Cisco Systems Inc.
 is the second-biggest seller of firewall
 software and third in VPNs. And Cisco
 has an advantage: It can embed secu-
 rity features right into its networking
 equipment. Check Point fights back
 by forming alliances with other hard-
 ware makers, such as Nokia, and by
 making its software run on every ma-
 jor type of computer. With such a
 broad reach, it's likely to remain the
 moneybags in this business.

By Jim Kerstetter in San Mateo, Calif.



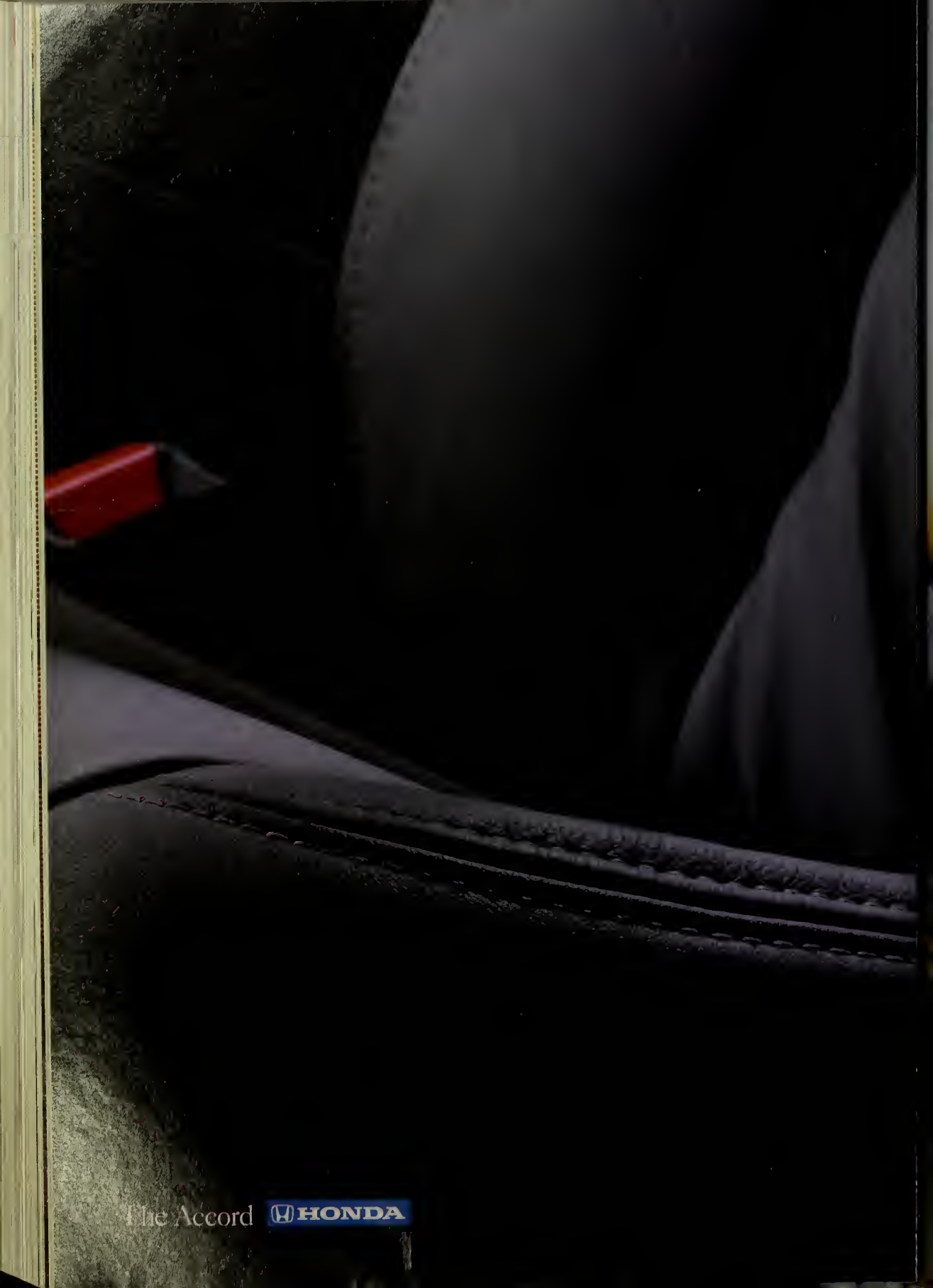
CHECK POINT SOFTWARE

10

Gil Shwed, CEO

Sales of security
 software have held up
 better than other
 categories because

Web traffic keeps growing. For now,
 Shwed sees no need to stray from
 his niche, noting: "Corporations will
 always need security."



The Accord



It's hard to tell who the car is hugging more, you or the road.



LESS-IS-MORE COMPUTING

Server makers have made a vital discovery: No one wants an energy-sucker that needs a baby-sitter

For years, corporate computing has been a game of addition: Computer makers focused on building servers with more processors and more number-crunching strength so the machines could do more jobs. Now computer manufacturers are finding out what the makers of Miller Lite and Diet Pepsi have long known: In many cases, less can be more.

That's because customers these days want computers that are less filling. With data centers costing \$50 million or more to build, companies need smaller devices so they can cram more high-octane computing oomph into less space. They want machines that use less power, both to save on electric bills as energy costs skyrocket and so the machines can be packed close together without frying each other. And companies want gear that can take better care of itself. The sorry truth is that the expense of configuring and fixing computers is higher than the boxes themselves. Companies are fed up with paying armies of techies to maintain these complex systems. "If you look at the total cost of ownership of

any hardware, the biggest cost is people," says Jerry A. Scaggs, a technology vice-president at freight hauler United Parcel Service Inc. "Equipment needs to be able to manage itself much more than it does today."

Computer makers big and small are heeding the call. Market leaders such as IBM (No. 6 in *BusinessWeek's* Info Tech 100), Dell Computer (No. 35), and Sun Microsystems (No. 65) are selling servers roughly the size of a pizza box that can be stacked in racks and take up far less space than traditional machines that are at least as big as a college-dorm refrigerator. Last year, 1 million of these slimmed-down servers were sold, vs. 3.6 million bigger ones, according to researcher IDC.

MIDGET INVASION. Now, upstarts are taking midget servers to the next level. Companies such as RLX Technologies Inc. and FiberCycle Networks Inc. sell book-size "blade" computers that are little more than a processor on a circuit card. They're so small that 20 of them can fit in the space of one pizza-box-size unit. That's math that the big computer makers can't ignore: By this winter, expect Dell, Compaq, and Hewlett-Packard to introduce blades as well. Says Duane Zitner, Hewlett-Packard's president of computing systems: "This is a huge business, and we intend to provide all of the [products] our customers want."

The blade servers fill the new lightweight bill in other ways, too. Most chips that require less power. Houston-based RLX, for example, sports the electricity-sipping Transmeta C processors found in some laptop computers and wireless gizmos. And they're designed to be a breeze to install: Most blades come preconfigured to do just one task, such as serving Web pages, they can be set up in minutes. Even more important, sp

WEIGHT WATCHING

For years, manufacturers concentrated on "big iron"—expensive servers that do anything from printing files to managing oceans of financial data. Now, penny-pinching customers want to lighten up. Here's what they're asking for:

SMALL IRON

Data centers cost about \$50 million to build. Those prices have led to a surge in sales of pizza box-size servers that can be stacked in racks. Now, computer makers are going smaller with "blade" servers that look like thin PC-cards, and get 20 times the computing punch per rack.

LOW POWER

Smaller servers use less power, a big deal given high energy bills. Plus, machines that run cooler can be packed closer to one another, increasing computing power per square foot. Upstarts RLX and FiberCycle are leading the low-power charge. Compaq, Dell, and Intel are right behind.

NO HASSLE

Maintaining servers can cost more than buying them. So server makers are starting to offer machines that can be serviced remotely. IBM is developing technology that can detect server problems and fix them with almost no human help.



By this winter, expect Dell, Compaq, and Hewlett-Packard to introduce stackable "blade" servers

ware links the blades together so if one unit fails, it can be replaced easily. "We want to offer the best foot soldiers, not the best general. If you're the general, you're screwed. If you're the foot soldier, you've got 10,000 of them," says Giovanni Coglitore, of Rackable Systems, a San Jose (Calif.) company that will soon begin selling blade servers.

Easy setup and replacement are just the first steps in reducing staffing needs to incorporate tech departments. Upstart Ade Communications Systems Inc. (San Jose) makes switches that can automatically shuttle Net traffic and other data between servers and storage devices. That boosts the utilization of customers' existing storage and frees well-technicians from having to spend their time typing in commands to keep track of the data. And Silicon Valley start-ups like Easent, NetScaler, and Peakstone are writing smart software that makes

the growing potpourri of servers operate in concert. Like an orchestra conductor, these programs direct server computers to the greatest need at any moment—say, speeding up a company's e-mail system as workers sit down at their desks in the morning and then shifting to printing end-of-day reports in the afternoon. The applications, says Peakstone Corp. CEO T.M. Ravi, "work like autopilot in a plane" to help reduce the workload for tech staffers.

Next up: so-called self-healing computers. IBM has pulled a number of efforts together into one grand, multibillion-dollar research and development project dubbed eLiza. It includes some existing technologies such as Intelligent Resource Director—software that anticipates glitches within a server and shifts the workload to other parts of the computer. Longer-term, scientists are racing to eliminate most human interactions, even as complexity skyrockets.

Consider Blue Gene, a supercomputer IBM is building to attack biotechnology problems. The machine, due out in 2004, will have a million processors working in tandem, and researchers at Big Blue fear that technicians would never be able to keep up with inevitable breakdowns. "Anytime you have a million of anything, something is going to fail," says Dave Turek, a vice-president of emerging technologies in IBM's server group.

TINY MARGINS? Self-managing machines will likely pad profits at companies such as IBM, but much of the lightweight movement threatens the fat margins in the server business. Although many server makers predict surging sales of blades, the product could end up as the equivalent of the sub-\$1,000 home PC. Sure, companies will sell a lot of them, but they won't make much money. As more manufacturers flood the market with blade servers, for example, their prices will quickly tumble to \$500, from today's levels of \$2,000 or more. "I would guess blade margins are going the way of the PC desktop"—about 10%, rather than today's 20%-plus, says IDC analyst Mark Melanovsky.

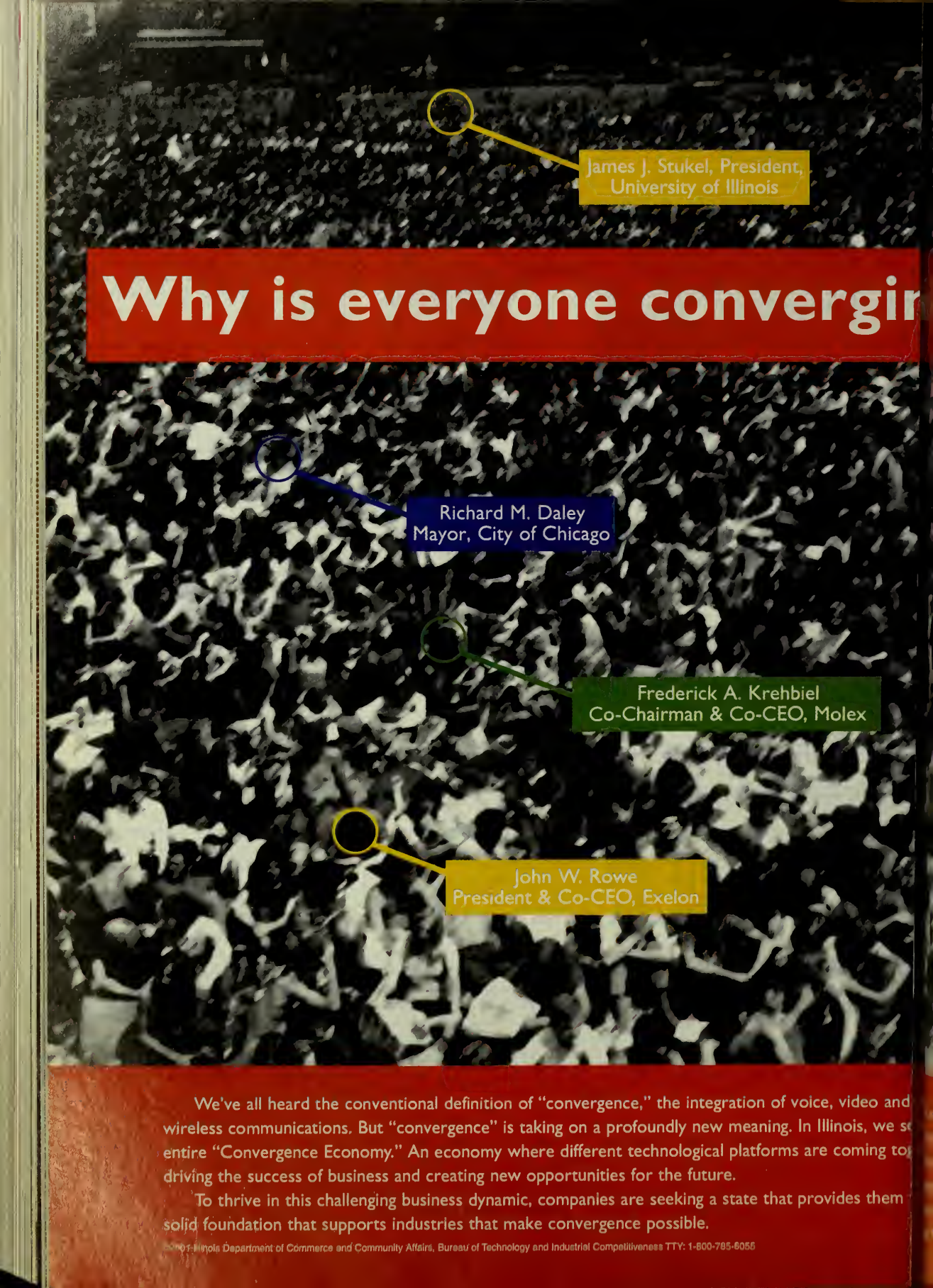
The cost of higher-end servers could fall as well as more tasks can be handled by the lightweights. Some users already are enjoying the new server math. Marty Boos, technology chief at e-commerce hoster Digital River Inc., no longer buys the \$1.5 million computers that have juiced Sun Microsystems Inc.'s margins in recent years. Instead, he recently

bought eight smaller systems that cost a total of just \$500,000.

These machines deliver the same computing punch as one of the pricier Sun machines, and they provide sufficient reliability for the tasks the machines carry out. "I'm glad someone is in the server business," he chuckles, "but I'm glad it's not me."

Sure, not every server will shrink to the size—or price—of a paperback. Most large companies still need top-of-the-line, million-dollar-plus models to store and manage the most sensitive corporate data—say, an airline's reservation system or a bank's customer accounts. But, increasingly, other duties will be handled by nine-foot racks filled with smaller, more streamlined devices that consume less power than their full-scale predecessors. And even the larger machines will require fewer staffers to monitor and manage them. That lightweight recipe adds up to big changes for computer makers.

By Peter Burrows in San Mateo, Calif., with Heather Green in New York



James J. Stukel, President,
University of Illinois

Why is everyone converging

Richard M. Daley
Mayor, City of Chicago

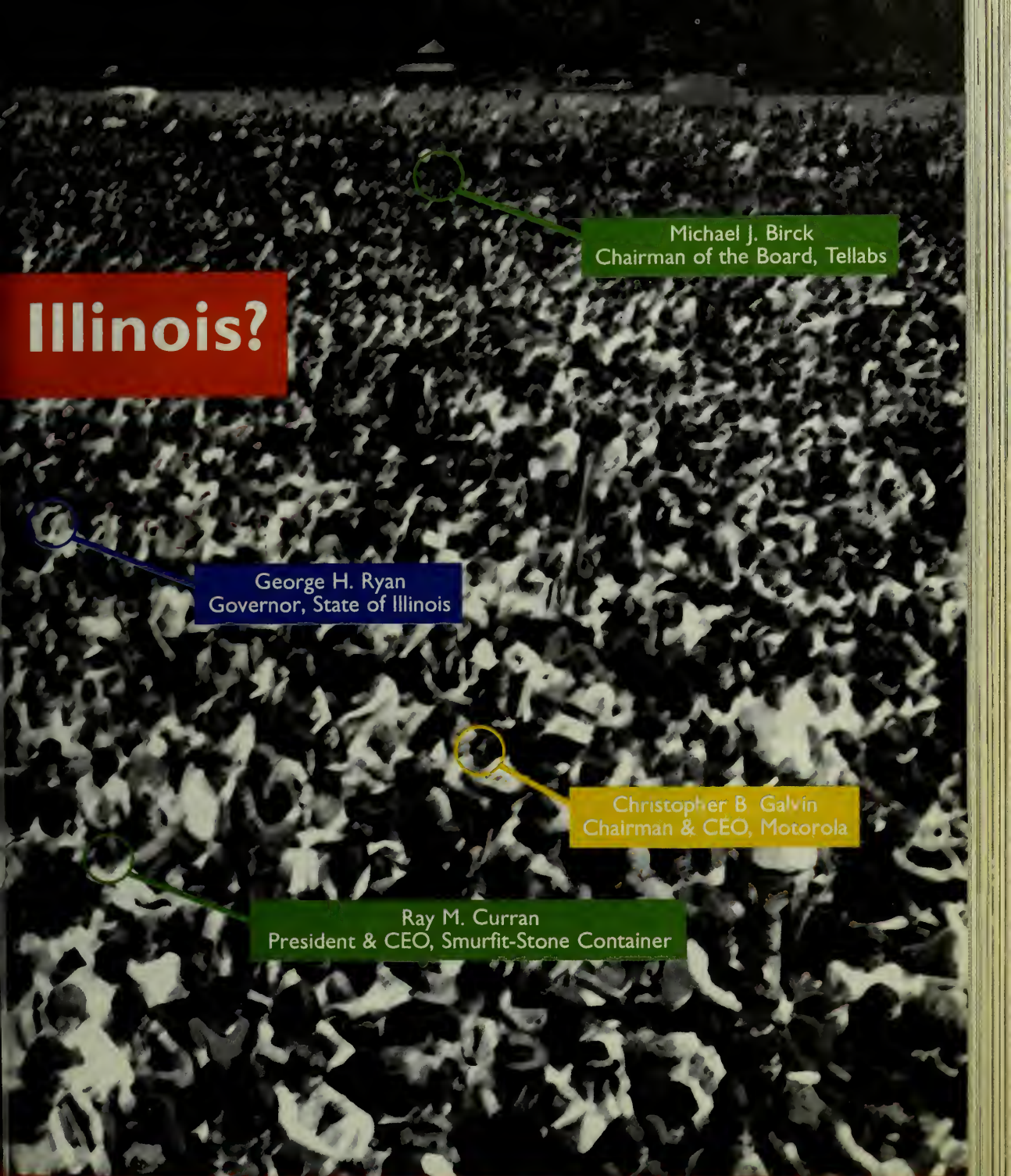
Frederick A. Krehbiel
Co-Chairman & Co-CEO, Molex

John W. Rowe
President & Co-CEO, Exelon

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SOFTWARE HIGHFLIERS



Amid the gloom, sales of customer and supply-chain programs are still strong—and likely to keep growing

When potato-chip pioneer Herman W. Lay started his company in 1938, he spent so much time visiting customers and suppliers scattered around Nashville that his Model A Ford might as well have been his office. By 1980, Lay's little potato-chip outfit had been melded into Frito-Lay Co., a multibillion-dollar division of PepsiCo. But that growth came at a cost. The business lost touch with its customers and its suppliers. So

over the next five years, Frito-Lay custom-built a \$40 million computer system to keep it plugged in.

It worked. Sales growth, which had dropped below 5% in 1981, returned to historic 20% to 30% levels by 1988. And thanks to wireless computing devices that gave warehouse managers a clearer sense of how chips were being delivered, Frito-Lay was able to cut inventories by about 20%. "I had a chance to meet Mr. Lay before he died," says Charles Feld, a technology consultant who was Frito-Lay's chief information officer in the 1980s, "and he always talked about finding a way to get back in touch with people."

Since then, with Frito-Lay as their inspiration, corporations have spent tens

of billions of dollars on computer software to make them seem as responsive to consumers as a corner store, yet as efficient as Wal-Mart. These investments are starting to pay off quicker, thanks to the Net—and software that lets companies connect with their customers and business partners cheaply and instantly. A manufacturer can rush to market with a product if its software spots a change in consumer tastes. And if demand drops overnight, it can coordinate with suppliers and avoid getting caught with unwanted inventory.

It's little wonder, then, that the bright stars in the software gloom are some of the top makers of customer management and supply-chain software.

el Systems,
14 on this
s IT 100 list, is
leader, with 17%
the market for soft-
ware that manages cus-
omer relations, according
MR Research Inc. Ger-
software maker SAP,
30 on the IT 100 list, has
at 7% of the supply-chain
ware market, ranking it sec-
in that category. And PeopleSoft is
23 on our list, thanks in part to Inter-
net software that lets an executive
pull all the moving parts of the company.
The newest versions of these compa-
ny software promise to be even more
effective. Rather than storing informa-
tion about customers in one spot and
others in another, the new software
brings together information about what
customers want to systems for coordi-
nating with suppliers. Companies are
able to collaborate with suppliers
jointly design products that are easily
manufactured.

It's a booming business. This year, com-
panies are expected to spend \$22
billion on customer and supply-chain
software, according to AMR. And these
markets are still young. By 2004, ana-
lyst peg spending on these programs—
with cost upwards of \$1 million—to
\$54 billion. In comparison, the mar-
ket for corporate-finance and human-re-
sources software is expected to rise
from \$20 billion to just \$25 billion.

Perhaps most surprising is that the tech-
nology economy has not put the brakes
on sales. A March Morgan Stanley Dean
& Co. survey of technology
spending plans for this year shows that
customer-management and supply-chain
software ranked No. 1 and No. 3, re-
spectively, with No. 2 being e-business
structure software. A February
study also found that 87% of execu-
tives plan to green-light customer and
supplier-management projects.

Why? Analysts say that using this
technology can shave 15% to 20% off a com-
pany's expenses. Panasonic Company
Japan, for example, has reduced the
time it takes to order parts from suppliers
and deliver finished consumer-electronics
products to customers by 75% since it in-
stalled supply-chain software from
i2 Technologies Inc. Panasonic gathers
sales information directly from dealers
and runs it through a forecasting
system, so it rarely runs out of more than
a week's worth of inventory on hand. "We can
anticipate what the demand

BUSINESS-SOFTWARE BIGWIGS

SIEBEL SYSTEMS

14 Siebel has 17% of the market for software that helps manage customer relationships. But bigger rivals, such as Oracle and SAP, could gain by tying their customer software to supply-chain programs.

SAP

30 Scorned for being a Net laggard, SAP has returned to top form after developing software that runs an entire business online. Now, the giant is trying to spark creativity by moving R&D out from under bureaucratic headquarters in Germany into tiny business units.

PEOPLESOFT

33 Two years ago, PeopleSoft's aging technology and management problems derailed the company. Thanks to new software designed for the Internet to handle everything from supplier to customer relationships, it's back on track.

will be, and it protects us from risks on big pricing changes," says Panasonic President Michael Aguilar.

Companies installing customer-management software expect big savings, too. "The payback on this is going to be quick," says Don Boerema, senior vice-president for business development and strategy at AT&T Wireless. AT&T is using Siebel's software to cut its customer-service costs. The project, which cost an estimated \$5 million, will improve automation of AT&T call centers, reducing the number of service reps needed to field customer questions by 15%. AT&T Wireless won't say how much it expects to save overall, but analysts estimate that it could be 15% to 20% of customer-service

costs. The software also gives sales-and-marketing staffs handy access to customer information over the Internet so they can pitch customers new services.

To be sure, this kind of software has had its share of problems. Four or five years ago, only 20% of customer-relations software installations were deemed successful by corporate customers, says Rod Johnson, an AMR analyst. Now, according to AMR surveys, that has jumped to over 70%.

Credit the Internet. With more companies doing business using simple browsers and Web pages, a lot of the complexity has been taken out of these systems. Conducting business transactions over the Net can be done 90% cheaper than over the old, privately owned computer networks, according to Goldman, Sachs & Co. At the same time, industries are quickly adopting new technology standards, such as Extensible Markup Language, that makes it easier for software packages to communicate with one another without human intervention.

It's that kind of integration of one software program with another that makes it possible for companies to keep close track of what's going on in their businesses. Carreker Corp., a Dallas-based tech consultant to financial-services companies, is outfitting its 300-person sales force with PeopleSoft customer software. The program keeps track of what services customers buy, and that makes it easier for Carreker to put together special offers for individual customers. And once Carreker has provided services for that customer for a number of months, it can run business-analysis software that taps into its financial programs to see if the relationship is boosting Carreker's bottom line.

The next big thing is expected to be collaborative software, which allows ideas, not just data, to be passed back and forth between companies. Enporion, an online marketplace for energy-producing equipment, plans to use SAP software that lets engineers at its large utility clients share plans with engineers at equipment suppliers. That could cut development time for something like a steam turbine from 18 months down to 12, says Enporion CEO Joseph R. Zelechowski. "Engineers talking to engineers is almost like a small company talking to a small company," he says. "It's very intimate." That's just the way Herman Lay did business when he was driving his Ford around Tennessee.

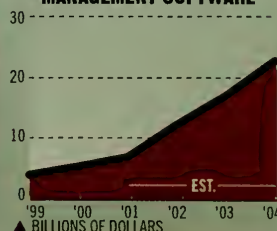
By Jim Kerstetter in San Mateo, Calif.

WHAT SLUMP?

MARKET FOR CUSTOMER-MANAGEMENT SOFTWARE



MARKET FOR SUPPLY-MANAGEMENT SOFTWARE



Data: AMR Research Inc.



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M A C R

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WILL THE BABY BELLS CRACK, TOO?

As telecom reels, they've been stalwarts. But the slowdown and new rivals could take their toll

Amid the wreckage in the telecom industry, the giant local telephone companies have been pillars of stability. With near-monopolies in providing local phone service, Verizon Communications, Qwest Communications, Alltel, and similar companies overseas have been able to crank out steady financial results while their rivals have suffered from overcapacity and the slowing economy. The result? Many of them scored top spots in *BusinessWeek's* annual ranking of the top technology companies in the world. Verizon hit No.2, Alltel took the No.31 slot, and Qwest showed up as No.78.

So are local phone giants truly safe havens in the telecom maelstrom? Plenty of experts think so, including Lehman Brothers Inc. analyst Blake Bath, who did some of the best research that anticipated the industry's current troubles. He believes the Bells will continue to perform well, while the long-distance companies will suffer from falling prices, and the upstarts will run out of cash. That could set the stage for Verizon, SBC Communications, and BellSouth to each buy one of the Big Three long-distance companies: AT&T, WorldCom, and Sprint. "It's over," says Bath. "They've won the war."

But telecom's giants are hardly without risk. There are early signs that the slowing economy will take a toll on them in the months ahead. SBC recently conceded that it won't meet Wall Street's earnings estimates for the rest of 2001. On June 1, BellSouth said it will miss its earnings estimates for the second quarter. And some analysts fret that Verizon will be next. Analyst Dan Reingold of Credit Suisse First Boston downgraded Verizon to "buy" from



"strong buy" because he doesn't think the company can earn the \$8.6 billion this year that Wall Street is expecting.

Why the concerns? While customers don't unplug their phones when times get tough, they do slow their purchases of the new services that have provided strong growth for local phone players in recent years. They may, for example, be less willing to buy a new mobile phone or extra local-phone services, such as voice mail and caller identification. On top of that, competition is bringing prices down for everything from long distance to wireless service. Already,

SBC's wireless-revenue growth is expected to slow to about 15% this year from 20% in recent years, according to Sanford C. Bernstein & Co. "We're a little concerned about growth over the next year," says Brian Hayward, portfolio manager at Invesco Telecommunications Fund, which held stakes in the Baby Bells, ranging from 5% to 10% in Verizon to 182,000 shares in Qwest, as of Mar. 31.

Of more concern is the data market. Verizon and others are counting on a surge in revenues from Internet and data services in the next few years.

boost growth. Verizon's data revenues are projected to rise from about \$10 billion last year to \$15 billion in 2005, according to Bernstein. But competition from giants such as WorldCom as well as smaller players remains intense. That could drive down prices and crimp revenue growth. Consider upstart Cogent Communications, which has raised \$426 million in financing so far. It offers companies a 100-megabit connection to the Internet for \$1,000, which is nearly 100 times the capacity companies typically get from their local phone company for the same price. "Our marketing strategy is simple: Bandwidth is a commodity, and our service is 100 times cheaper," says Cogent Executive Dave Schaeffer. "That's a very dangerous proposition."

With that kind of pressure, Verizon and its peers are hardly shoo-ins to dominate the industry. They'll have to compete well, particularly in the new markets they are entering—data, long distance, and wireless. "I don't think there is a safe haven," says Ivan Seiberg, co-CEO at Verizon. "Our story is that we got ahead of the industry. As long as you stay one step ahead of the posse, you're O.K."

LANDING. Verizon is doing more than its peers in the long-distance market. After winning regulatory approval to enter the New York market last year, the company has added about 22% of the state's consumer market. That helped boost its long-distance customers to 5.2 million at the end of March, up 500,000 from last year. And that's just the beginning: As Verizon wins regulatory approval in more states, Bath figures its long-distance revenues will rise from \$3.2 billion this year to more than \$5.2 billion in 2003.

Verizon's future in the data market may not be as bright. Its data business unit was spun out as an independent company to satisfy regulatory constraints last year and is expected to be acquired as early as 2003. But Genuity struggled since becoming independent as corporations have slowed their spending on data services and its cash flow has become tight. In May, the company laid off 800 employees and reported that its revenues this year will be more than \$1.4 billion rather than \$1.8 billion it had previously projected. "It's no great shakes these days," says Hayward.

Certainly, the local telephone giants have shown rare stability during the telecom meltdown of the past year. But their future is hardly assured. They'll have to demonstrate that they're capable of executing in new communications markets before they can declare victory in the telecom game.

By Peter Elstrom in New York

MEXICO'S 800-POUND GORILLA

Telmex' quasi-monopoly is a safe haven for investors

Almost 10 years after Teléfonos de México was privatized, Mexicans still find reasons to hate the phone company. Even though the days of snarled lines and surly staff have passed, consumers now fume over mystery charges and insistent dinner-time calls urging them to return to Telmex long-distance service.



TELEFONOS DE MEXICO

13 Chairman Carlos Slim

Telmex controls virtually all of the local telephone lines in the country, so every new entrant in wireless services, Internet access, or international long distance has to pay a toll to the company to originate or terminate phone calls.

None of that need worry investors. Telmex' strong performance pushed it to No. 13 on *BusinessWeek's* annual ranking of the top tech companies in the world. Although the Mexican market has been open to competition for four years, the company is still a quasi-monopoly. Telmex boasts 58% of the market for international calls originating in Mexico, 68% of the domestic long-distance market, and 97% of the local market. "Anyone who wants to do business in the telecom industry in Mexico has to do business with Telmex," says analyst Michel Morin of Merrill Lynch & Co.

Telmex' control over local phone lines means the company gets a cut of

all the growth in Mexico's estimated \$12 billion telecom market. Cellular-phone companies, Internet service providers, and long-distance rivals must pay Telmex to complete calls on its network. Interconnection traffic rose 43% in the first quarter thanks to Mexico's wireless boom. That helped boost Telmex's net income 25% last year, to \$2.7 billion on revenues of \$10.7 billion. Telmex' net margins of 25% are almost double the 13% average for full-service telecom companies around the globe, says Merrill Lynch.

Investors are taking notice. Telmex shares have risen 10% over the past year, to about \$35, while the Standard & Poor's Telecom Index has dropped 50%. "Telmex has proven to be a real safe-haven stock," says analyst Josh Milberg of UBS Warburg.

Its execs have worked hard to keep it that way. Chairman Carlos Slim, Latin America's richest businessman, has aggressively fought off attempts to regulate the company more tightly. Last December, when a more independent government came to power, Slim quickly cut a compromise agreement with long-distance competitors Avantel, a WorldCom joint venture, and Alestra, backed by AT&T, to lower the fees long-distance rivals pay Telmex to complete calls on its local network. The move has taken the punch out of new regulatory efforts.

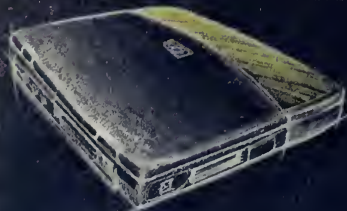
Slim is proving just as adept at boosting revenues. His focus is on data services, both connecting consumers and businesses to the Net and transmitting their data. Morin figures the company's data services, which account for about \$1 billion now, will rise to \$3.8 billion in 2005 as more Mexicans get onto the Web.

Certainly, Telmex is facing competitive pressures. The lower termination fees for long-distance calls will spur more players in that business, which now accounts for more than one-third of Telmex' revenues. And some rivals are beginning to enter the local phone market. "Competition is a real pressure," says Milberg. "It's not like the sky is going to fall on Telmex, but competitors are in a position to take 1% to 2% of market share a year." Still, as rivals are learning, it takes a lot to tackle Telmex.

By Elisabeth Malkin
in Mexico City

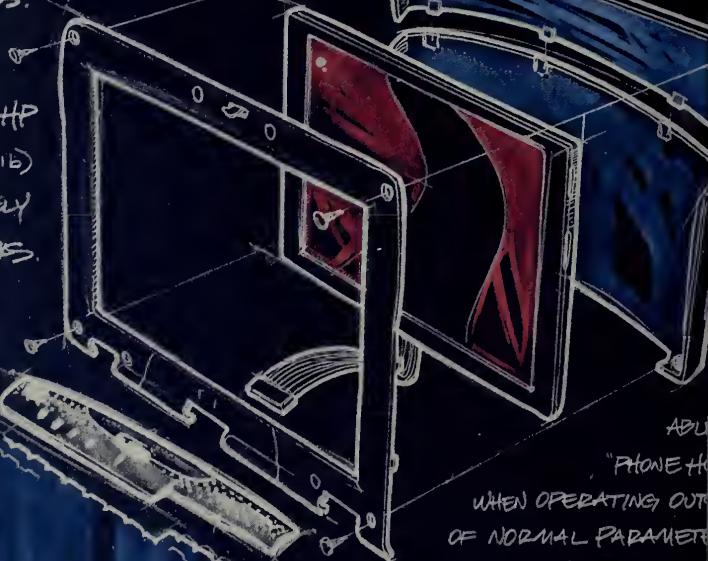
FINAL QRD CHECKPOINT MARCH 4, 2000
PROJECT NAPOLEON (HP OMNIBOOK 6000)

DESIGN GOAL: MAX. PERFORMANCE/IN.³



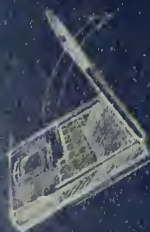
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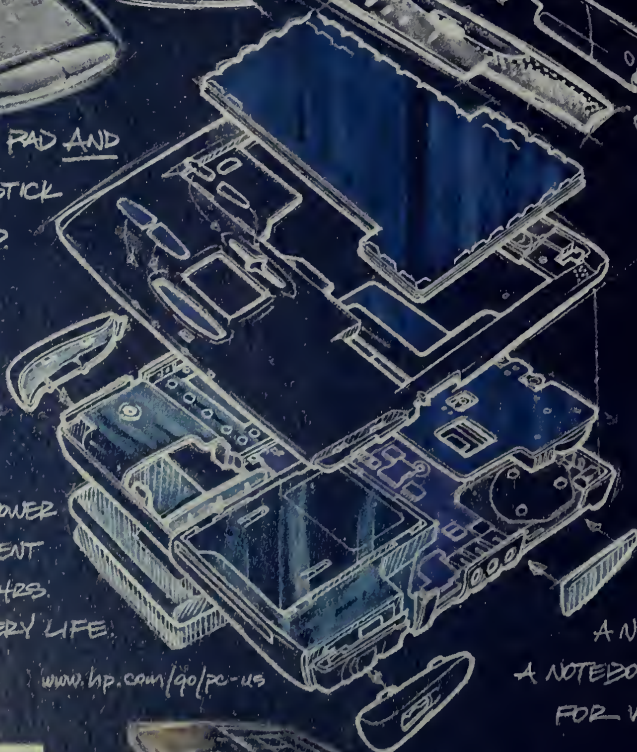


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i n v e n t

TECH STOCKS: WHAT THE STREET LIKES



CHRIS SHILAKES

First Vice-President, Merrill Lynch & Co.

CATEGORY: Software

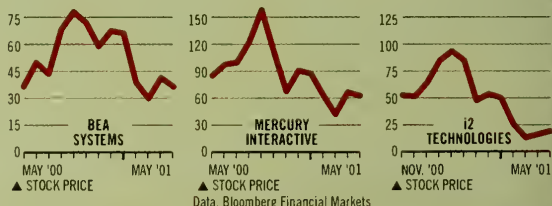
STOCK PICKS: BEA Systems (BEAS), Mercury Interactive (MERQ), i2 Technologies (ITWO)

WHY: In a market rife with earnings blowups, Shilakes is backing three software companies that are leaders in high-growth niches. One of his favorites is BEA Systems Inc., the top maker of so-called application servers—building blocks of corporate e-commerce systems. Shilakes says BEA has the chance to become “one of the next key platform providers in the software industry.” He expects annual sales growth of 40% to 45% from this profitable software maker for the next five years, although that’s down from 60% to 75% the past two years. BEA’s stock price, 35 now, should rise to 40 within the year. The risk? With a price-earnings ratio of more than 100, “it carries a fairly high premium.”

Another Shilakes fave is Mercury Interactive Corp. The Sunnyvale (Calif.) company is the leader in programs that monitor Web performance, boasting such customers as Citigroup, Amazon.com, and Wal-Mart Stores. Last year, Mercury had revenue of \$307 million, a 64% increase over 1999. Shilakes says it will do well

in tough times because the software helps cut product-development costs and is relatively inexpensive. Shilakes’ price target for Mercury’s stock, which is trading at 60, is 100.

Shilakes’ final pick is the “gorilla” of the supply-chain software market, i2 Technologies Inc. “Supply chain is a critical three- to five-year trend to any manufacturer,” says Shilakes. This software helps companies link suppliers for faster turnaround and to keep inventories low. Shilakes predicts i2 will break even this fiscal year on \$1.3 billion in revenues and earn \$107 million on revenues of \$1.6 billion in fiscal 2002. i2’s stock is around 21 now. Shilakes has not come up with a new target since i2 surpassed the old one of 20.



JOSEPH OSHA

Analyst, Merrill Lynch & Co.

CATEGORY: Semiconductors

STOCK PICKS: Transmeta (TMTA), Texas Instruments (TXN), Linear Technology (LTC)

WHY: Investing in semiconductor stocks nowadays might take you on a path where only fools dare to tread. With pc and cellular-phone sales expected to remain weak for the rest of this year, many chip stocks have tanked. But Merrill Lynch & Co. analyst Joe Osha says there are a few poised to make a strong comeback, with products aimed at promising mobile and portable markets. Companies that provide powerful, smaller chips that are less of a battery drain will capitalize the most, he says.

A favorite is Santa Clara (Calif.) upstart Transmeta Corp., which makes chips that offer the most performance for the fewest volts in notebook computers and other electronic devices. The only chip stock Osha rates a “buy,” Transmeta has a product “that’s very well-suited for the direction the portable device market is taking.” Osha expects Transmeta’s shares to rise nearly fivefold in the next 12 to 18 months, to 61 from 12 today.

Another pick is Texas Instruments Inc., which hit a wall earlier

this year. Sales of its digital signal processing chips, found in cell phones and toys, slumped amid the economic downturn. B. Osha rates it an “accumulate,” which he says means it’s a go long-term holding. TI is “still the shop to beat” when the market for gizmos and gadgets recovers, he says. His 12- to 18-month price target is 60 a share, up from 34 today.

Linear Technology Corp., he says, also has considerable room to grow with the market for mobile devices. It is a leader in power management and battery charging technology. Osha, who also rates Linear “accumulate,” says its leadership position will help boost its shares to at least 70 over the next year or so, up from 49 today.



Is there still money to be made in the tech sector? Even after its recent rally, the tech-heavy Nasdaq index is down 57% from its high in March of 2000. Still, these Wall Street mavens think there are plenty of opportunities in the tech world. Some of their selections, such as Texas Instruments, are old-timers with deep strengths. Others, like Global Crossing, are once-highfliers maybe poised for a resurgence. And others, like Transmeta, are upstarts with promise.



ANDREW J. NEFF

Senior Managing Director, Bear, Stearns & Co.

CATEGORY: Hardware

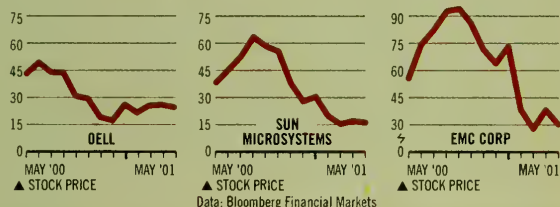
STOCK PICKS: Dell Computer (DELL), Sun Microsystems (SUNW), EMC (EMC)

Andrew J. Neff turned heads in January when he declared that Dell should buy Gateway, Hewlett-Packard should buy Compaq Computer, and Apple Computer should start building Windows computers. No one has taken his suggestions so far, but consolidation is under way—and Dell Computer Corp. is its biggest beneficiary. The company, Neff says, is slashing prices and stealing market share from its rivals. Because of its low operating expenses, helped by recent layoffs and a restructuring, it's the only one making a buck on PCs. Dell's future growth will come from servers, storage hardware, and support and consulting services that generate higher margins than PCs. After flat revenues and a decline in earnings this year, Neff expects Dell to return to double-digit revenue and profit growth next year. He projects its shares, now at 25, could hit 40 within 12 months.

Neff is also keen on Sun Microsystems Inc. Once companies can no longer rely on moving their operations to the Internet, he

thinks Sun will get most of the demand for powerful servers. Revved-up servers and workstations based on Sun's new line of powerful microprocessors are rolling out now, meaning Sun's stock has the potential to pop. He bets the stock, which is trading at 16½, could go to 24 in the next year.

Although Neff figures it will be a while before the storage sector rebounds, he thinks EMC Corp. makes a good bet when it does. Neff calls EMC's hardware "life insurance" for companies because it protects their vast stores of critical data. He doesn't expect revenue and earnings to increase much this year, but predicts they will surge 25% in 2002. He sees shares jumping to 45 next year, from their current 31½.



JACK B. GRUBMAN

Managing Director, Salomon Smith Barney

CATEGORY: Telecom services

STOCK PICKS: WorldCom (wcom), Qwest Communications International (q), Global Crossing (gc)

Jack Grubman, a fanatical boxing fan and onetime amateur boxer, isn't afraid to lead with his chin. The analyst has been bloodied over the past year as many of his favorite stocks, notably WorldCom Inc., have been hammered. So what is Grubman recommending these days? Well, WorldCom again tops the list, putting him in the minority of Wall Street analysts who favor the stock. He also likes Qwest Communications International Inc. and Global Crossing Ltd.

The stocks of many long-distance companies were pounded as competition from new upstarts drove prices down. Now, with many of the upstarts in trouble and the Baby Bells shying away from aggressive price competition as they enter the market, Grubman says prices are stabilizing and it's time to once again get up to these stocks. "All the riff-raff is gone," he says. With more stable prices, WorldCom and other long-distance companies should see respectable revenue growth for Internet and

data services. Grubman expects WorldCom's revenues will grow 12% to 15% next year, pushing its stock from 18 to 30 within a year. Global Crossing, which has built an extensive international telecom network, should also benefit from stabilization in rising global traffic. At 12 a share, Grubman says it's a "steal" and expects it to more than double in a year.

Qwest is a near-consensus pick among the analysts who follow it. The company boasts steady financials because of its purchase of Baby Bell US West last year. What may push up its revenue growth, Grubman says, is its long-distance network, which is capable of carrying voice and data. He figures the revenue boost should push its stock from 36 to 50 inside of a year.





GREGORY GOULD

Managing Director, Goldman, Sachs & Co.

CATEGORY: Services

STOCK PICKS: First Data (FDC), Affiliated Computer Services (ACS), Electronic Data Systems (EDS)

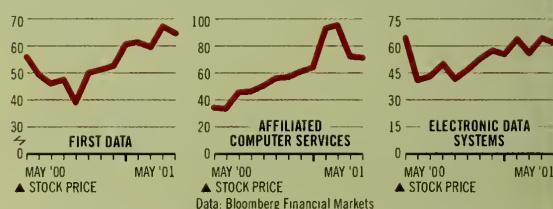
WHY: In a rocky economy, companies that can help in the quest to save money will flourish, says Gould. Especially outsourcing. As corporations attempt to lower costs, they're turning to others to handle services such as payroll processing and telemarketing. The total amount shelled out to such outsourcing companies should double to more than \$300 billion by 2004, according to market researcher International Data Corp.

Gould has two favorites in the field: Affiliated Computer Services Inc. and Electronic Data Systems Corp. Half of ACS's \$2 billion in annual revenues comes from managing not only client computer networks but also entire functions such as payroll or benefits administration. Gould expects ACS's stock to rise to 86 over the next 12 months from 72, fueled by a 25% growth in earnings, to \$170 million.

EDS is similarly well positioned. Gould says the company will likely boost revenues 14% this year, to \$21.9 billion, and earnings 18%, to \$1.3 billion. Another plus: EDS's aggressive management team, led by CEO Richard H. Brown, which took over two years ago. After it expanded and retrained the sales force, the

rate of new-client wins rose to 45% from less than 35%. Gould expects the stock to jump to 78, from 62½, in the next year.

Another Gould pick is First Data Corp., which he figures will benefit from an anticipated 50% surge over the next decade in electronic payments, such as credit-card and money-wiring services. FDC's largest and fastest-growing business is Western Union, which is seeing rapid growth from two groups of people that frequently wire cash back and forth: those who don't have their own bank accounts and expatriates. Western Union is expanding internationally, signing contracts this year to open branches in India and China. "That's exposure to nearly half the world's population," says Gould, who expects sales and earnings to climb 13% in 2001 to \$6.4 billion and \$997 million, respectively. He predicts the company's shares will rise to 78 within a year, from 63½.



PAUL JOHNSON

Analyst, Robertson Stephens

CATEGORY: Communications equipment

STOCK PICKS: Sonus Networks (SONS), ONI Systems (ONIS), Extreme Networks (EXTR)

WHY: Remember how the first PCs cost almost as much as a car—and weighed nearly as much, too? People certainly get more for their money these days. That's because the amount of computing power one can buy with a dollar doubles every 18 months. "That phenomenon, known as Moore's Law, is about to enter the telecom world," says telecom-gear analyst Paul Johnson of Robertson Stephens. Johnson thinks the coming change will define the new winners in the communications-equipment field.

Johnson counts Sonus, ONI, and Extreme among them. He has "buy" recommendations on all three and expects substantial jumps in their stocks in the months ahead. He doesn't put out specific price targets, but he thinks the shares of all three could rise fivefold over the next three to four years. Today, ONI trades at \$32.55, Sonus at \$27.35, and Extreme at \$29.65.

The trump card: Each makes equipment that telecom companies need to stay competitive while lowering costs. For example, ONI's gear, which turns information into light and carries it across local phone networks, provides just as much capacity as rivals'

products at half the price, Johnson says. That's because ONI's gear uses smaller parts that are scalable, require less maintenance, and consume less power than traditional gear. Its equipment is also easier to use: Using ONI's gear, a telecom can allocate extra bandwidth to one customer with a few clicks of a mouse. With most rivals' equipment, carriers must send staffers out to the customer's offices.

Sonus directs voice calls with routers based on Web technology rather than more expensive traditional phone gear, lowering operating costs by 20% or more. Extreme makes next-generation, dem-like devices that let carriers sell 100-megabit Net connections for \$1,500 a month—less than one-fourth the price rivals have been charging. "Carriers must lower costs, and they will reward suppliers who help them get the job done," Johnson says.



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				\$ MIL.	RANK	%	RANK	%	RANK	%	RANK	\$ MIL.	\$ TH.
1	CELESTICA (CLS) The IBM spin-off reached \$10 billion in sales a year ahead of schedule. Now it's aiming for \$20 billion by 2003.	Contr	Canada	10832.3	36	85.9	30	8.8	127	35.7	30	235	295
2	VERIZON COMMUNICATIONS (VZ) Despite the telecom downturn, the phone giant has solid financials due to its near-monopoly in local-phone markets.	Tele	U.S.	66441.0	3	12.7	152	31.7	27	9.8	55	11000	24
3	SCIENTIFIC-ATLANTA (SFA) Its digital set-top cable-TV boxes are so hot that they may propel it past leader General Instrument, now part of Motorola.	Comm	U.S.	2445.0	91	61.1	57	23.3	47	17.2	43	319	17
4	NVIDIA (NVDA) Scored big with the Microsoft Xbox game console deal as it expanded its graphics-chip business beyond the desktop PC.	Semi	U.S.	827.7	157	83.1	32	23.2	48	74.7	16	108	93
5	CHINA MOBILE (HONG KONG) (CHL) † Fifty million subscribers—and growing. It's the cellular leader in China, which will soon be the world's biggest mobile market.	Tele	Hong Kong	7850.1	46	68.3	48	21.5	55	-17.4	111	2178	21
6	IBM (IBM) Big Blue is back and stronger than ever. The caveat: Apart from services and chips, growth has been spotty.	Svcs	U.S.	90092.0	2	4.1	193	39.1	14	11.1	52	8324	28
7	TELEFONICA MOVILES (TEM) † ‡ Wireless spin-off from Spain's phone leader has raked in profits at home but now faces a rough battle with Vodafone.	Tele	Spain	6948.2	52	37.6	92	48.6	5	-18.6	113	609	
8	UNITED MICROELECTRONICS (UMC) † ‡ Management shakeup shunted aside Chairman John Hsuan, but the No. 2 chip foundry is a leader in new technology.	Semi	Taiwan	3168.0	78	248.4	4	21.3	56	-23.8	127	1531	
9	AMERICA MOVIL (AMX) † ‡ Telmex's wireless spin-off is set to grow on mobile explosion in Latin America.	Tele	Mexico	3010.3	80	86.6	27	14.9	89	2.2	69	105	
10	CHECK POINT SOFTWARE (CHKP) It's top of the heap in security software, which many consider to be one of the top priorities in tech spending.	Soft	Israel	492.1	186	93.8	25	41.5	9	14.8	47	270	
11	ADVANCED MICRO DEVICES (AMD) The little-engine-that-could mentality has this chipmaker gaining on Intel. Now it's moving into notebooks and workstations.	Semi	U.S.	4740.9	67	42.9	78	28.7	29	-9.9	93	942	26
12	SANMINA (SANM) The contract manufacturer took a wallop from the telecom meltdown. Still, its high-end services make for a bright future.	Contr	U.S.	4949.3	65	62.0	53	14.1	96	10.8	54	277	16
13	TELEFONOS DE MEXICO (TMX) † The former monopoly still pumps cash. Now it's looking to data services to maintain growth as new rivals turn up the heat.	Tele	Mexico	10652.8	38	4.931	191	50.4	4	25.9	36	2600	
14	SIEBEL SYSTEMS (SEBL) Siebel's obsession with pleasing customers is paying off. But tough rivals such as Oracle want to horn in on its market.	Soft	U.S.	2064.4	103	109.0	18	16.7	78	0.5	72	264	
15	NTT DOCOMO Japan's cell-phone giant pioneered mobile Net services. Now it's trying to export them to tougher overseas markets.	Tele	Japan	41538.6	9	57.0	62	14.0	100	-14.0	106	3237	
16	HON HAI PRECISION INDUSTRY † Computer makers Apple and Dell both rely on this Taiwanese company's components.	Comp	Taiwan	2900.0	81	59.956	59	23.3	46	-10.6	95	303	321
17	NOKIA (NOK) Finnish cell-phone power is grabbing market share as rivals languish. But doubts about the mobile Net are sapping confidence.	Comm	Finland	29243.6	16	32.7	104	36.4	17	-31.3	146	3755	43
18	DDI CORP. (DDIC) Contract manufacturer designs and builds wireless communications gear for clients such as Alcatel, IBM, and 3Com.	Contr	U.S.	563.1	177	82.5	33	20.1	62	76.9	13	41	19
19	AMPHENOL (APH) It's the hardware store for the telecom industry—making connectors, circuits, and other nuts-and-bolts components.	Semi	U.S.	1376.3	129	28.2	115	266.4	1	18.5	42	116	17
20	JABIL CIRCUIT (JBL) This contract manufacturer focuses on the troubled telecom market, so rivals could outpace its growth.	Contr	U.S.	4371.1	69	61.2	56	12.6	104	4.9	63	174	20

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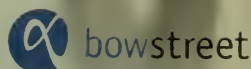
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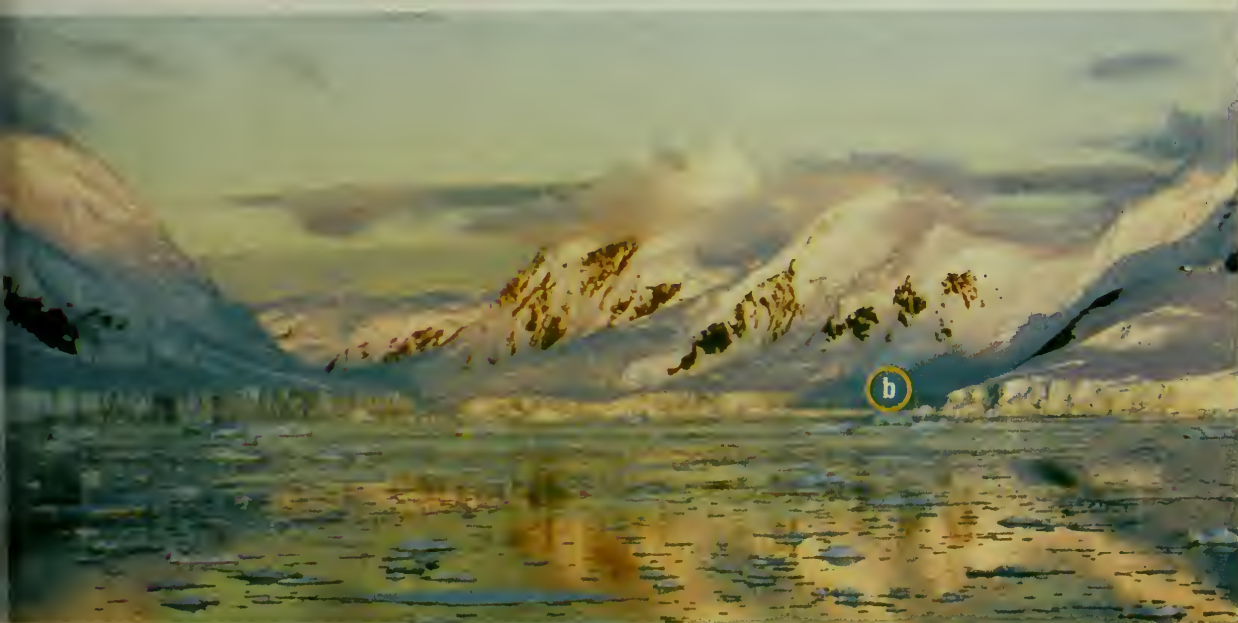
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21	SOLETRON (SLR) The big kahuna of contract manufacturers got hit hard by the slowdown, laying off nearly 10,000 workers.	Contr	U.S.	19495.2	26	78.8	36	10.8	113	-20.8	119	603	218
22	INTERNATIONAL RECTIFIER (IRF) Little-known IR is the premier maker of chips that regulate power in laptops, cars, even satellites.	Semi	U.S.	1025.5	143	53.3	67	17.1	74	75.6	15	170	135
23	CIRRUS LOGIC (CRUS) The rise of digital music plays well for this audio processing chipmaker. But wrangling over standards could hamper sales.	Semi	U.S.	778.7	159	38.0	91	32.9	24	43.6	26	142	459
24	TAIWAN SEMICONDUCTOR (TSM) The biggest chip foundry has cut back capital spending. It's still pushing ahead with next-generation plants, though.	Semi	Taiwan	5304.2	62	85.1	31	23.0	49	-36.9	161	1887	332
25	FLEXTRONICS INTERNATIONAL (FLEX) This acquisitive contract manufacturer kept zipping along in 2000, with growth of 74%.	Contr	Singapore	12109.7	32	74.0	42	-11.1	189	18.6	40	-446	110
26	STMICROELECTRONICS (STM) Unlikely chip star proves doubters wrong by eschewing PCs and thriving on digital gizmos and communications.	Semi	Netherlands	8032.1	45	42.3	81	24.6	40	-27.3	138	1555	164
27	MICROSOFT (MSFT) Growth may be slowing, but new products and \$30 billion in the bank will make Gates & Co. more dominant than ever.	Soft	U.S.	24645.0	20	7.5	184	20.9	57	15.3	46	10065	605
28	INTEGRATED DEVICE TECH. (IDTI) Stepping up its push into new markets for its communications chips; could stumble as it switches focus from older technology.	Semi	U.S.	991.8	146	41.3	84	36.4	18	6.4	60	415	132
29	SWISSCOM (SCM) † Profits could wane at the Swiss carrier as competition heats up with rivals from France and Denmark invading its turf.	Tele	Switzerland	8750.2	43	24.9	124	36.0	19	-22.4	123	1920	371
30	SAP (SAP) The Old Economy is back, and so is this German software giant. It rules in basic corporate applications.	Soft	Germany	6111.9	58	21.4	130	26.0	36	-7.5	87	639	
31	ALLTEL (AT) Its focus on second-city markets has helped Alltel outperform giant telecom brethren AT&T and WorldCom.	Tele	U.S.	7219.9	48	9.5	170	39.6	11	-4.2	82	2126	258
32	AVX (AVX) Strong sales in high-margin, proprietary products boosted this electronic components maker last year.	Semi	U.S.	2608.1	87	60.0	58	36.6	16	-32.2	151	568	86
33	PEOPLESOFT (PSFT) There's no magic to its march back from the brink of two years ago. Good corporate software really does count.	Soft	U.S.	1864.1	112	28.2	116	15.2	86	231.4	2	165	21
34	MAXIM INTEGRATED PRODUCTS (MXIM) Specialty chipmaker finds growing use in devices, ranging from cell phones to handheld computers.	Semi	U.S.	1153.6	140	50.2	73	27.4	32	-0.1	74	379	20
35	DELL COMPUTER (DELL) Dell is getting mean, with a price war that has bloodied rivals—and catapulted it past Compaq to become No. 1 in PCs.	Comp	U.S.	32636.0	11	20.8	133	39.5	12	-38.3	163	2173	74
36	FIRST DATA (FDC) The credit-card processing king and owner of Western Union is on a roll. But will its bet on electronic payments pay off?	Svcs	U.S.	5833.2	60	4.8	192	26.1	35	25.7	37	955	19
37	BCE (BCE) The parent of Bell Canada is seeing a surge in revenues thanks to growth in data and wireless services.	Tele	Canada	12735.1	31	23.5	126	8.3	130	22.6	38	952	16
38	KEMET (KEM) Based in Simpsonville (S.C.), Kemet is one of the world's largest makers of capacitors—electronic devices essential to comp	Semi	U.S.	1406.1	126	71.0	45	39.8	10	-31.2	145	352	5
39	CAP GEMINI † Merger with Ernst & Young Consulting boosts French company in America. But it wreaks havoc on morale at home.	Svcs	France	7618.5	47	96.2	24	10.5	115	-28.9	142	400	11
40	LINEAR TECHNOLOGY (LLTC) Rang up strong sales of chips used in cell phones and laptops. Distribution problems, though, could take their toll.	Semi	U.S.	983.6	147	54.8	65	25.6	38	-1.5	78	431	23

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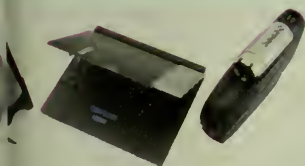
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				\$ MIL	RANK	%	RANK	%	RANK	%	RANK	\$ MIL	\$ T
41	KYOCERA (KYO) <i>The world's largest maker of ceramics for integrated chips is also Japan's leading maker of mobile phones.</i>	Semi	Japan	10708.0	37	35.7	96	24.1	42	-32.9	154	1829	
42	ASUSTEK COMPUTER † <i>This Taiwanese producer of motherboards is pushing aggressively to manufacture in China.</i>	Comp	Taiwan	2146.0	101	44.4	76	35.4	20	-25.4	133	475	
43	CDW COMPUTER CENTERS (CDWC) <i>Strong sales in software and storage have CDW humming. The pressure is on to keep revenues up while prices drop.</i>	Svcs	U.S.	3965.7	72	37.4	94	27.4	33	-25.2	131	167	138
44	ANALOG DEVICES (ADI) <i>Makes chips that help transform analog signals into digital formats in cameras, cell phones, and other electronic gadgets.</i>	Semi	U.S.	2880.0	82	53.1	68	25.9	37	-29.8	144	685	24
45	CERNER (CERN) <i>Technology solutions for the health-care industry have kept Cerner in good shape.</i>	Svcs	U.S.	438.4	189	28.7	113	33.0	23	95.7	9	109	
46	AUTOMATIC DATA PROCESSING (ADP) <i>This pioneer of hosting applications for others has been providing outsourced payroll services for a half-century.</i>	Svcs	U.S.	6888.7	53	14.2	145	19.3	65	0.6	71	894	14
47	COMPAL ELECTRONICS † <i>A producer of notebook PCs for Compaq, this Taiwanese powerhouse is perfecting the art of supply-chain management.</i>	Comp	Taiwan	2260.2	95	58.4	60	20.5	59	-22.1	121	182	15
48	ELECTRONIC DATA SYSTEMS (EDS) <i>The services giant is retooling and cutting \$1 billion a year in costs, while e-consulting upstarts have run out of gas.</i>	Svcs	U.S.	19637.7	25	3.7	194	25.1	39	-1.2	77	1324	15
49	SCANSOURCE (SCSC) <i>The Greenville (S.C.) company's bar-code scanners are a hit. Sales continue to soar despite a slowing economy.</i>	Svcs	U.S.	607.6	172	37.5	93	19.4	64	101.3	7	17	100
50	MICRON TECHNOLOGY (MU) <i>It's the last pure play in memory chips. Its hyperefficient ways should help it weather the downturn.</i>	Semi	U.S.	6996.7	51	57.3	61	18.2	68	-37.0	162	1357	3
51	L-3 COMMUNICATIONS HOLDINGS (LLL) <i>Spun off after the merger of Lockheed and Loral in 1996, L-3 can now sell its components to rivals of its former parents.</i>	Comm	U.S.	1994.9	105	32.4	106	11.8	109	49.4	22	86	1
52	EMC (EMC) <i>Data storage may have been immune to the slowdown last year, but now the market leader is feeling the chill.</i>	Comp	U.S.	9395.0	40	33.2	102	22.1	52	-32.0	149	1849	3
53	TECH DATA (TECD) <i>While other electronics distributors have gone bust in recent years, this Florida company has emerged stronger than ever.</i>	Svcs	U.S.	20427.7	23	20.2	135	14.9	90	-10.8	96	178	18
54	NIDEC <i>Nidec makes precision motors that run disk drives and CD-ROMs for IBM, Fujitsu, and other computer makers.</i>	Comp	Japan	2207.5	98	80.0	35	8.4	129	-8.5	89	88	
55	LEXMARK INTERNATIONAL (LXK) <i>So much for the paperless office. Lexmark's inexpensive printers and printing supplies continue to be a great business.</i>	Comp	U.S.	3914.7	75	10.1	165	32.6	26	-6.2	85	285	3
56	JUNIPER NETWORKS (JNPR) <i>The maker of Internet routers is the only company ever to compete against Cisco and take market share.</i>	Comm	U.S.	941.7	152	501.9	3	23.9	44	-32.8	153	198	6
57	TELLABS (TLAB) <i>Under new CEO Dick Notebaert this telecom-equipment company is moving from voice switching to optical networking.</i>	Comm	U.S.	3528.3	77	42.0	82	27.7	31	-38.6	167	762	3
58	SUNGARD DATA SYSTEMS (SDS) <i>The financial-services and software giant is remaking itself through the Internet.</i>	Svcs	U.S.	1716.9	118	16.2	143	15.0	88	97.0	8	225	2
59	BROCADE COMMUNICATIONS (BRCD) <i>Tops in connecting servers to storage banks. Its 60% share in storage switches make it king of this red-hot market.</i>	Comp	U.S.	504.5	184	225.6	5	17.5	72	-11.2	98	92	5
60	CIENA (CIEN) <i>Ciena's products get more oomph out of optical networking. Still, it faces fierce competition from Nortel and Lucent.</i>	Comm	U.S.	1298.2	134	113.5	17	1.5	165	15.5	44	56	2

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	COMPANY (STOCK SYMBOL)	SECTOR	COUNTRY	REVENUES		REVENUE GROWTH		RETURN ON EQUITY		SHRHLDR. RETURN		PROFITS	SAL PER
				\$ MIL.	RANK	%	RANK	%	RANK	%	RANK	\$ MIL.	\$ T.
61	ALTERA (ALTR) A pioneer in special logic chips that run everything from answering machines to wireless networks.	Semi	U.S.	1391.5	128	50.8	72	38.0	15	-32.7	152	485	66
62	AFFILIATED COMPUTER SVCS. (ACS) Not a household name, but it has more than 10,000 clients for its tech consulting services, rivaling giant EDS.	Svcs	U.S.	2041.5	104	8.3	180	15.4	84	118.5	3	128	10
63	BEA SYSTEMS (BEAS) The top maker of Web application servers is riding high, but can it fend off IBM?	Soft	U.S.	923.2	153	73.4	44	7.7	136	18.6	41	50	26
64	ACT MANUFACTURING (ACTM) Acquisitions helped drive sales growth in 2000. But key customers include hard-hit telecom and networking companies.	Contr	U.S.	1586.8	121	103.6	19	12.4	106	-24.7	130	28	17
65	SUN MICROSYSTEMS (SUNW) After zooming past IBM to become U.S. server king in 2000, Sun has faced slowing sales in the tech downturn.	Comp	U.S.	19271.8	27	35.3	97	16.9	76	-43.8	176	1789	40
66	ORACLE (ORCL) The database king isn't immune to the slowdown, but its business applications are saving it from the no-growth zone.	Soft	U.S.	10970.1	35	13.1	150	124.3	2	-50.3	190	6619	22
67	ADOBE SYSTEMS (ADBE) This ain't no high-wire act. The maker of Web publishing software Acrobat is very profitable and on solid ground.	Soft	U.S.	1313.1	133	22.6	128	39.4	13	-14.4	107	293	39
68	MENTOR GRAPHICS (MENT) Chipmakers break out their Mentor design software to come up with their next hit bit of silicon.	Soft	U.S.	616.2	171	19.3	137	20.4	60	76.1	14	61	20
69	VIA TECHNOLOGIES † Having reached the top of the chipset sector, Taiwan's chip designer is now taking on Intel and AMD in microprocessors.	Semi	Taiwan	949.7	151	166.8	11	14.3	94	-23.9	128	201	14
70	AGERE SYSTEMS (AGR.A) ‡ Once Lucent's crown jewel, Agere makes lasers and other components used in optical networking systems.	Semi	U.S.	5228.0	64	32.2	107	-6.7	181	35.0	32	-387	10
71	CONVERGY'S (CVG) Billing systems. Customer care centers. They're not sexy, but companies spend a lot on them.	Soft	U.S.	2226.7	97	18.7	138	17.3	73	-1.0	76	204	10
72	MOBILE TELESYSTEMS (MBT) ‡ Russia's top mobile-phone operator continues to attract customers and cut costs.	Tele	Russia	600.0	175	61.7	54	12.1	107	13.1	49	102	10
73	FAIRCHILD SEMICONDUCTOR (FCS) † The company that helped spawn the computer chip industry makes chips for everything from cellular phones to air bags.	Semi	U.S.	1783.2	115	54.5	66	32.6	25	-45.6	179	273	10
74	ITOCHU TECHNO-SCIENCE The computer systems integrator just keeps growing on sales of Sun Microsystems and Oracle products.	Svcs	Japan	2682.5	85	45.5	75	9.2	123	-12.9	102	131	10
75	CADENCE DESIGN SYSTEMS (CDN) No stutter here. Electronics manufacturers love its design software, but its stock is pricey.	Soft	U.S.	1366.7	130	34.6	99	6.7	140	66.3	18	66	20
76	SABRE HOLDINGS (TSG) The world's biggest computer reservation system aims to dominate travel bookings online and off.	Svcs	U.S.	2545.9	88	11.9	158	8.3	131	87.7	10	79	20
77	MICROMUSE (MUSE) Nobody likes it when their computer network goes kaput. Micromuse's software troubleshoots systems before it's too late.	Soft	U.S.	183.2	195	117.9	16	9.4	121	9.6	56	17	20
78	QWEST COMMUNICATIONS (Q) The Denver company's Net and data services are driving growth, and it has stable cash flow due to its acquisition of US V	Tele	U.S.	18284.0	28	36.5	95	-1.1	171	-10.3	94	-466	20
79	FISERV (FISV) The back-office-services company for banks and brokerages regularly clocks earnings gains of 20% to 30%.	Svcs	U.S.	1711.1	119	16.7	140	14.0	97	28.6	34	185	10
80	EPCOS (EPC) Falling demand for cell-phone parts is hurting margins at this Siemens spinoff. New gadgets could boost growth next year	Semi	Germany	1858.6	113	34.3	101	43.1	6	-40.2	171	262	10

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				\$ MIL.	RANK	%	RANK	%	RANK	%	RANK	\$ MIL.	\$ T.
81	BROADWING (BRW) This telecom player has stable earnings from its Cincinnati Bell business and nationwide growth potential in broadband.	Tele	U.S.	2168.2	99	63.4	51	-20.1	192	12.6	50	-355	25
82	DST SYSTEMS (DST) This software house has prospered selling services to banks and brokers. The challenge: moving beyond the financial sector.	Svcs	U.S.	1392.7	127	9.7	169	16.7	77	57.9	20	214	12
83	IDT (IDT) IDT is picking over struggling phone companies to add assets on the cheap to its international telecom empire.	Tele	U.S.	1099.2	141	10.2	164	71.8	3	-7.3	86	849	66
84	ATMEL (ATML) It has benefited from heavy demand for memory chips that store information when an electronic device is turned off.	Semi	U.S.	2109.4	102	43.6	77	14.5	93	-23.4	125	280	20
85	COMVERSE TECHNOLOGY (CMVT) Creates messaging services and other features for the wireless industry. But it has cut jobs to meet financial targets.	Comm	U.S.	1225.1	138	34.7	98	20.2	61	-12.8	101	249	18
86	CHECKPOINT SYSTEMS (CKP) Makes radio ID systems that help retailers track inventory and prevent theft.	Comm	U.S.	691.1	165	52.1	69	3.4	155	81.9	11	7	10
87	WIPRO (WIT) ‡ Operating in India and Silicon Valley, Wipro is sitting pretty with its fast-growing outsourcing consulting business.	Svcs	India	662.0	167	26.5	120	33.7	22	-9.5	91	137	1
88	PLEXUS (PLXS) Electronic manufacturing services have been a good business, but the company's telecom customers are hurting.	Contr	U.S.	994.9	145	77.1	39	11.7	110	-14.6	108	47	14
89	TRAVELOCITY.COM (TVLY) The leading online travel site is taking off, but could be threatened by a new airline-backed competitor, Orbitz.	INet	U.S.	238.5	194	196.3	10	-22.8	194	105.9	6	-66	1
90	PEREGRINE SYSTEMS (PRGN) It's flying high thanks to its software that helps companies keep tabs on assets such as computers and office equipment.	Svcs	U.S.	564.7	176	122.9	14	-61.3	197	70.4	17	-852	1
91	LOGITECH INTERNATIONAL (LOGIY) Of mice and joysticks: The Swiss company is riding computer peripherals to record profits.	Comp	Switzerland	761.4	160	23.7	125	17.6	71	14.3	48	45	1
92	VODAFONE GROUP (VOD) The first global player in wireless, Vodafone is feasting during the downturn, buying competitors from Spain to Japan.	Tele	U.K.	21290.7	22	69.9	46	-6.7	182	-32.9	155	-13854	4
93	EXTREME NETWORKS (EXTR) Extreme makes modem-like equipment that offers Internet connections that are 100 times faster than most modems.	Comm	U.S.	468.6	187	125.7	13	-10.7	187	61.5	19	-57	3
94	ANRITSU The NEC affiliate makes communications equipment and measurement gear for customers such as NTT and Japan's government.	Comm	Japan	1408.8	125	38.2	90	0.5	168	48.2	23	85	1
95	RICOH The maker of printers and copiers saw the digital light years ago. It's now a world leader in networked office equipment.	Comp	Japan	13639.5	30	6.4	190	8.3	133	11.0	53	471	1
96	POWER-ONE (PWER) Its converters power products made by leading telecom companies. Still it must diversify to offset dimming demand.	Comp	U.S.	603.8	173	119.4	15	9.6	119	-12.4	100	62	1
97	TELEFONICA (TEF) † Spanish telco boasts a cleaner balance sheet than its rivals. One big blemish: the \$12 billion spent on Web portal Lycos.	Tele	Spain	26742.2	19	10.6	161	9.7	118	-14.7	109	2352	2
98	VISHAY INTERTECHNOLOGY (VSH) The electronics component maker squeaked onto the list, but the slumping economy is hurting sales and profits.	Semi	U.S.	2484.6	89	32.4	105	28.0	30	-47.4	184	534	1
99	MACRONIX INTERNATIONAL (MXICY) † From its two fabs in Hsinchu, Taiwan's Silicon Valley, Macronix produces flash memory chips for Nintendo and others.	Semi	Taiwan	978.1	148	81.1	34	23.8	45	-45.9	182	322	1
100	INFINEON TECHNOLOGIES (IFX) German memory chip maker prevailed in defense against patent infringement; could be derailed by weak PC sales.	Semi	Germany	6404.8	57	22.4	129	18.5	67	-34.4	156	994	1

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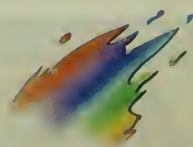
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CLICKING AT GRAYBAR

The 132-year-old electrical switch and cable outfit has revamped its warehouse and distribution system

From its earliest days, Graybar Electric Co. had been fast, but not quite fast enough. Company lore holds that its founders thought in the 1800s they had invented a breakthrough improvement on the telegraph—only to be beaten to the patent office by hours. In 1997, the Internet was creating booming demand for technology goods, but the Clayton (Mo.) distributor of communications and electrical gear was being left behind again. Too often, Graybar simply couldn't get its products to customers quickly and efficiently. With a tangle of 231 local distribution centers, each run as an independent fiefdom, the company could take a week to fill an order and the goods could come from as many as eight different branches with eight different bills to pay.

Enough, said the company's leaders. Carl L. Hall, then CEO and now chairman, told managers that Graybar would have to dig deep, coming up with \$144 million over four years to build 16 big warehouses to supplement its network of distribution centers. The goal was to centralize supplies of certain products so orders could be filled quickly and from one facility. It was a bet-the-company decision: The price tag to pay for

the expansion was more than two years of profits for the 132-year-old Graybar. What's more, it risked undermining the culture at the employee-owned company, where the local bosses had long had almost complete control over their operations. Still, Graybar's top brass thought it had no choice.

The bet is starting to pay off. In 2000, Graybar's sales surged 21%, to \$5.2 billion. That made Graybar the fourth-largest company on *BusinessWeek's* list of top private information technology outfits. The company's income hasn't accelerated as much because of the continuing heavy investments in warehouses. Net profits crept up 2% last year, to \$66.2 million. Still, Graybar expects to climb in the years ahead. The plan "has certainly hit our bottom line. We knew it would," says CEO Robert A. Reynolds Jr. "But in the

next five years, we'll have payback."

Certainly, customers are happier. Williams Communications Inc. and others can receive their orders overnight. In the past, shipments could take a week. Even better, the orders come from a single warehouse, so there's only one bill to pay. Williams Communications Group Inc., a Tulsa telecom upstart, buys cables and other gear from Graybar, has doubled its seven-figure business with the distributor in the past year, in part because of Graybar's efficiency. The distributor's competitors "are doing the same thing, but [Graybar] has been a little faster," says Shapiro, a senior buyer at Williams. **WHITE SHIRTS.** Not that change has been easy. Graybar is, simply put, an old-fashioned company. Back in the 1800s, it was part of Western Electric Co., the supplier of telephone gear for the Bell system. The distribution business was spun off in 1925 and bought by its employees in 1929. White shirt ties for men are still *de rigueur*. And it's not uncommon for execs to spend their entire careers at the company. Reynolds, for example, has been with Graybar since he graduated from college in 1964. "We're not a glossy company," Deborah Weis, the company's 37-year-old director of e-business, says. "It's a very old culture that takes a long time to change."

The biggest hurdle to overcome

GRAYBAR ELECTRIC CO.

4

Robert A. Reynolds, CEO

The supplier of cable, connectors, and other communications gear saw its sales zoom 21% last year, to \$5.2 billion, after a reorganization allowed it to deliver its products more quickly and efficiently.





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the tradition that local bosses had almost complete independence to run their distribution centers. They stocked what they thought customers in their region wanted, and if they didn't have enough of a particular product, they called around to other centers to round up supplies. Having the relationship with the customer was critical because the person who took the order got the commission—even if he didn't fill it himself. "If we had a large order, we could end up shipping from seven or eight warehouses," says Terry Loveless, a Graybar manager in Alabama. "It was a huge burden for the customer. Every warehouse sent its own invoice."

Because of the deeply ingrained culture, Reynolds was careful about how he put together the new corporate structure. Rather than taking away local independence or closing any branches, he is building the 16 new warehouses to coexist with the local facilities. After the first warehouses were built, Reynolds didn't

even order local managers to reduce their stock on hand. He wanted to make sure managers had the goods they felt that they needed. "We didn't want to cause service failures because of a change in business process," says Ed Keith, vice-president for logistics.

SLIM AND TRIM. With the new system, local managers have been reducing their inventories. They realize that they can rely on the warehouses for rarely needed goods and that it's easier for customers to get big orders from one place. Now, Loveless says his warehouse has about \$2 million in inventory, down from \$3 million in the past. Overall, the company's inventory fell by \$95 million last year, to \$748.7 million, despite the healthy sales growth.

Today, Graybar's biggest challenge is to keep sales growing fast enough to fill up all its warehouse space. With the telecom sector stumbling, Graybar is seeing sales growth slip. Revenues for the first quarter of 2001 were up just 2% over the same period of 2000.

Reynolds says he's not worried. He says that Graybar sells telecom equipment largely to big phone companies, such as SBC, Qwest Communications International, and Verizon Communications. He expects strong sales in the second year. He's confident enough that the company plans to complete its last warehouses on schedule in early 2001. "We have not slowed the investment," says Reynolds.

He has big plans after all. He expects a goal of \$8 billion in sales in 2001, more than 50% from last year. Graybar's employees think that the warehouse system will give the company a good chance of reaching the top. "It would have been virtually impossible to get there with the structure we had," says Loveless. Graybar, it seems, is beginning to learn the benefits of scale.

By Faith Keenan and Timothy Mullaney in New York

TOP PRIVATE INFO TECH COMPANIES

COMPANY	LOCATION	SECTOR	2000 REVENUES MILLIONS	CHANGE FROM 1999	COMMENT
ACCENTURE	Chicago	Services	\$10,300	10%	The newly named tech consulting and services company is on its own and doing just fine after splitting from its parent, Arthur Andersen.
SEAGATE	Scotts Valley, Calif.	Comp.	6,600	-2	Bye-bye, public markets. The manufacturer of hard-disk drives thinks its private status will help its long-term planning, including possible acquisitions to drive growth.
SAIC	San Diego	Services	5,900	7	Government contracts for tech outsourcing services helped this former defense contractor grow during a tough year. And investment gains in its venture-capital arm helped profit more than triple, to \$2.1 billion.
GRAYBAR ELECTRIC	Clayton, Mo.	Distrib.	5,200	21	Age didn't slow this 132-year-old company. It continued to grow on demand for its telecom and data equipment—copper cables, fiber-optic cables, and connectors.
SYNNEX	Fremont, Calif.	Contr.	3,700	24	A contract manufacturer that distinguishes itself with its distribution system. A shakeout in the distribution sector during 2000 helped boost growth for survivors like Synnex.
BLOOMBERG	New York	Services	2,500	25	Provider of financial info over the Web keeps on growing. But uncertainty may lie ahead as founder Michael Bloomberg hands over the chairman's duties and embarks on a political career.
DYNCORP	Fairfax, Va.	Services	1,800	29	The highflier that made its name in aircraft servicing won a \$752 million contract to offer simulated training to the U.S. Army and Marine Corps.
KINGSTON TECHNOLOGY	Fountain Valley, Calif.	Contr.	1,600	7	Dropped its networking and peripheral-products divisions in April to focus on memory chips. Memory for high-end servers and workstations helped drive growth in 2000, despite a tough market.
COMARK	Bloomington, Ill.	Distrib.	1,560	1	Resells hardware, software, and peripherals and provides e-business consulting services.
SHI	Somerset, N.J.	Services	1,391	53	The 11-year-old company has leveraged the Internet to win procurement outsourcing contracts.

Data: OneSource Information Services, company reports, BusinessWeek



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ON A ROLL: "Being competitive" is his goal, says North Carolina A&T's Craig (in blue shirt)

school ties with the corporate world. In the next few years, Reuben was able to raise some money, including \$1 million from the state legislature for improvements, such as renovating the B-school building. In April, the school came South Carolina's first B-school program at a historically black college or university to be accredited. That has come after a long period of under-prepared students, a 25% enrollment

EDUCATION

BIG STRIDES AT BLACK B-SCHOOLS

Talent-seeking companies are helping cash-poor institutions

When Lucy J. Reuben took over as dean of the business school at South Carolina State University six years ago, enrollment at the black college was in an eight-year slide. The university had all but ignored the small business school in favor of its popular liberal arts programs, and corporate recruiters were scarce. But Reuben, an ex-finance pro-

fessor at Duke and Florida A&M and executive at Ford Motor Co., was determined to turn things around. First on the list: win accreditation. It would be a ticket to respectability, and without it, serious fund-raising is difficult.

It also meant that a lot had to change on the Orangeburg campus. Reuben hired new faculty, beefed up classes, and used her personal Rolodex to form

ment increase, a more wired campus, high-quality jobs for students, and a new position dedicated to student services. "[Reuben] changed our mind. We were no longer a country school in Orangeburg," says 1999 graduate Tipton, now a financial analyst at permaker Bowater Inc. "We were determined to produce world business leaders."

READY POOL. South Carolina State is one of many black B-schools, most located in the South, undergoing something of a revival. Ever on the lookout for minority talent, corporate recruiters are knocking on these schools' doors. A growing roster of blue chips is helping bring money to endowment-strapped institutions as well as donating scholarships and arranging student internships. Ford, Abbott Labs, Fannie Mae, Bank of America have all signed some form of partnership. It's more than just good-deed-doing: Almost 40% of minority business students attend black schools, which translates into a pool of talent. Says Sandra Bue, manager of university relations for Morgan Chase & Co.: "These schools are attracting high-quality minority students, so we need to be there."

Founded around the turn of the century to educate minority students, black colleges for decades offered only menial business programs, with careers such as typing and shorthand. They started to change largely in the 1980s, when minority students began to find easier entry into the corporate ranks. Today, there are more than 100 black B-school programs, and they continue to provide a nurturing learning environment for minorities, enabling

THE ROAD AHEAD

Business programs at historically black colleges and universities have improved over the past decade, but challenges remain:

RESOURCES

Except for a few, most programs lack funding for more than the basics and look to Corporate America for money and support.

MARKETING

The programs usually don't allocate money for marketing or recruiting of top-notch students, instead of relying on word of mouth.

CORPORATE RECOGNITION

Many still suffer from their former incarnations as schools for typing and shorthand and are just now gaining clout.

UNIVERSITY FREEDOM

Black business programs often have to share money they raise with their parent institution. Big-name B-schools usually don't.

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more than 250,000 students. Whereas many majority, or mainly white, institutions have less than 10% African American undergrads, a mostly black school "allowed me to learn and get individual teaching in an environment that was more comfortable," says Torey Hammond, a South Carolina State alumnus.

Still, it has been difficult to overcome the legacy of second-class status. In the mid-1990s, the programs began to emerge from a nearly 15-year dry spell that saw several schools trim courses or shut down altogether. Before then, none of the 77 uncertified black business programs earned accreditation—a daunting process that can take five years and cost more than \$50,000. Schools that were succeeding had few resources to market themselves to potential students or recruiters. Even today, "there's [state] money for survival, but there's often no money for excellence, for being competitive," says Quiester Craig, dean of the B-school at North Carolina A&T State University in Greensboro, one of the first black B-schools to win accreditation in 1979.

NO E-MAIL. Indeed, the parent schools are notoriously underfunded, mostly relying on state appropriations, private foundations, and a trickle of corporate and alumni support. At majority schools, the big bucks that pay for fancy extras come from endowments, padded by successful alums. But black B-school grads don't move into high-paying positions at the same rate. So endowments are often in the hundreds of thousands of dollars range, vs. sums averaging \$16 million at mainstream schools. Shoestring budgets don't leave room for technology upgrades, recruitment, or marketing, says Melvin T. Stith, dean of Florida State University's B-school. "There are certain [schools] that don't have e-mail or voice mail," he says.

That's where Corporate America has quietly stepped in. Since the mid-1990s, when accreditation standards changed to include more schools, an outpouring of support from companies pushing diversity sent black B-schools on an improvement frenzy. KPMG Foundation has helped nearly a dozen earn accreditation since 1995, with money, mentoring, and plain old "encouragement," says Bernard J. Milano, head of the foundation and a board member of AACSB International, the main B-school accrediting body. "We cannot improve the diversity of Corporate America unless someone steps forward and helps these institutions," says Milano. As more companies discover black B-schools and commit time and money to their success, changing the complexion of the corporate world should get a whole lot easier.

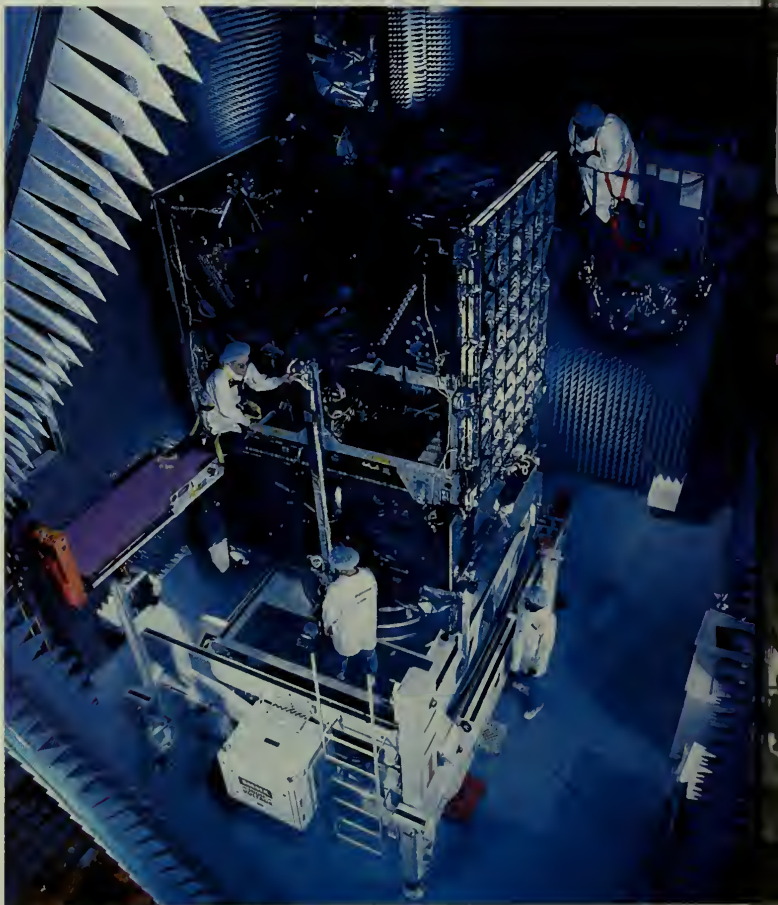
By Jennifer Merritt in New York

The Corporation

STRATEGIES

BOEING'S WOBBLY SATELLITE ORBIT

Its new unit must exploit unproven technology



Just south of Los Angeles International Airport in El Segundo, tucked between two glass towers, is a sprawling, windowless yellow building that's crucial to Boeing Co.'s strategy of expanding far beyond commercial aircraft. A former Nash Rambler auto factory, it's now where a big share of the world's communications satellites are meticulously assembled one by one by teams of workers in white gowns and then shipped out at about \$100 million a pop.

Last year, Boeing paid Hughes Elec-

tronics Corp. \$3.75 billion for this satellite-making operation. According to the flight plan, the deal would not only put Boeing into the satellite business but even into high-margin, space-based services such as linking airline passengers to the Internet, digitally delivering movies to theaters, and whatever else it needs could think up. Today, however, satellite manufacturing is losing a while the payoff from the service

DOG DAYS

It's one thing to make a satellite, another to s

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The Corporation

remains distant and iffy. That's not helping Boeing's goal of becoming more than just an aircraft maker, an aim underscored by its planned move this August to Chicago from its Seattle manufacturing base.

Boeing executives brim with confidence that eventually the payoff from services will be huge. James F. Albaugh, CEO of the Space & Communications Group, which includes the satellite unit, cautions skeptics that focusing just on the low-margin satellite-manufacturing operation misses the point of

why Boeing bought Hughes. He says Boeing bought the intellectual capital of Hughes—the people who developed the fast-growing DirecTV satellite television service and other technologies. And Boeing intends to leverage that brainpower into new space-based businesses—most of them not yet discovered. “We are going to use the brains of

El Segundo to help us get into the services arena,” Albaugh says.

PHONE PROBLEMS. For now, though, satellite manufacturing is the unit's breadwinner, and Boeing didn't get into the business at the best time. Demand for commercial satellites is declining, and excess production capacity worldwide now hovers around 35%. That's largely due to the financial failures of satellite-phone companies Iridium, New ICO, and Globalstar, which wrecked the market for low-orbiting satellites. And satellite-communications outfit Teledesic LLC, backed by billionaires Craig McCaw and William H. Gates III, is sharply cutting back plans for a 288-satellite constellation, probably to about 50 satellites. One problem: Financing for those costly birds is drying up, prompting some analysts to ratchet down 10-year forecasts for commercial-satellite orders by more than a third.

Meanwhile, just as demand is falling, the competition is getting tougher. Last year, European rivals Alcatel and Astrium grabbed more than half of the worldwide orders for commercial satellites, up from just 16% the year before. One reason is that tougher U.S.

export rules give the European competitors an advantage in winning overseas orders. Plus Boeing is no longer assured orders from Hughes's PanAm-Sat, Spaceway, and DirecTV units. Now, it must compete for that business against U.S. rivals Lockheed Martin Corp. and Loral Space & Communications Ltd., as well as the European upstarts. The result: The Boeing unit received just seven commercial satellite orders last year, down from 13 in 1998.

Albaugh sees the market differently. Demand for low-orbiting satellites may

be dropping, but he says the company is well-positioned to capitalize on a growing number of government contracts. Boeing recently snagged a \$5 billion Defense Dept. contract to build next-generation spy satellites under a classified project called the Future Imagery Architecture. And the

satellite unit has a nice backlog of 35 commercial and government orders for large, geostationary satellites, worth \$6 billion. “A lot of people bad-mouth the satellite business,” Albaugh says, “but we feel pretty good about the market.”

Even if the market improves, though, Boeing has other headaches. Some of its satellites have been losing control or power in orbit, a quality problem inherited from Hughes. At least six have gone dead or will be prematurely shut down because customers say they are unreliable. Insurance will cover most of the cost, but the lost credibility may hurt future orders.

One big problem, however, was resolved in April when Boeing put its own man in charge of the unit. Satellite President Tig H. Krekel and Executive Vice-President Joseph M. DeSarla, both Hughes holdovers, abruptly quit after differing with higher-ups over the unit's direction. Boeing was quick to fill Krekel's job with a NASA veteran, Randy Brinkley, who joined the unit last year. At NASA, Brinkley was credited with helping to get the troubled international-space-station project back on track.

The \$2.1-billion satellite unit

historically churns out 8% margins. Boeing is looking for double-digit gains, and that's where space-based vices come in. Execs gush about for using satellites to beam the Internet down to jetliners—a projected \$1 billion-a-year business within 10 years. They talk eagerly about delivering run movies to theaters via satellite, horn in on the billion-dollar-a-market for film distribution. And satellites are the centerpiece of an air-traffic control system that Boeing plans to unveil later this month. Says Boeing Chairman and Chief Executive James M. Condit: “That integration is a pretty exciting task.”

NO TAKERS YET. But turning these initiatives into profitable, high-growth businesses is another matter. Even Condit acknowledges that these projects are best five years away from producing steady revenues—if they survive. Boeing's effort to beam the Net to jetliners, which it calls Connexion, has yet to attract a firm customer. The unit is under pressure to line up one by the time the Paris Air Show on June 17. There's Boeing's Air Traffic Management plan to alleviate airport congestion, which faces regulatory hurdles as it competes with systems from an IBM-led team and the Federal Aviation Administration. And Boeing's digital cinema must overcome skeptics in the movie industry and high costs to convert theaters. Boeing did succeed in transmitting the movie *Spy Kids* to a California theater in March and argued it can cut distribution costs while improving film quality.

Still, the strategy faces high hurdles. “Although it's not impossible to convert intellectual capital to bottom-line earnings growth, this kind of transformation is tricky to pull off,” says Robert E. Friedman, an aerospace analyst for Standard & Poor's Equity Group. Boeing has to prove it can invade Hollywood and master the Internet if it's going to avoid getting lost in space.

By Stanley Holmes
in Los Angeles

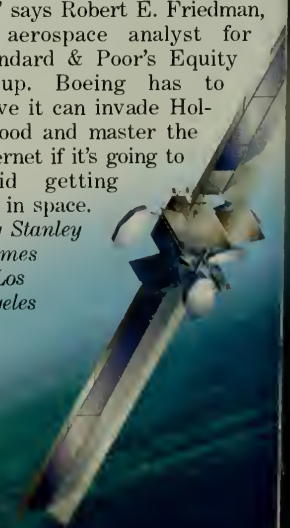
WHAT BOEING IS UP AGAINST

Tougher federal export control laws are crimping overseas orders

Demand is collapsing for low earth-orbiting commercial satellites

No quick payback expected on Internet and other satellite services

European challengers are growing stronger





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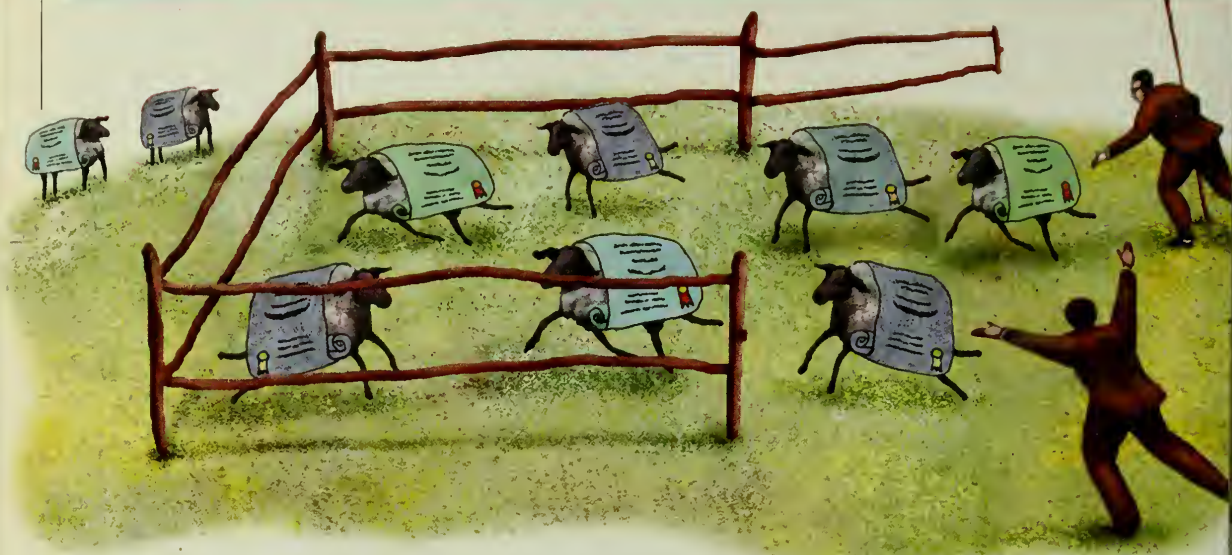
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EQUITIES

FLOCKING TO DIVIDENDS

Forget capital spending, investors want a payoff right now

After five interest-rate cuts by the Federal Reserve, policymakers and investors impatiently wonder why they're not seeing an iota of revival in the corporate capital spending that once powered the economy and bull market. The roadblock may well be within the stock market itself. Look closely, and you'll see that a powerful body of shareholders are telling corporations to boost payouts for share buybacks and dividends before spending more on new technology.

"We had such robustness in capital spending, that now the investment community is voting with their feet and saying, 'Rein it in,'" says Steve Galbraith, stock strategist at Morgan Stanley Dean Witter & Co. The evidence: Companies that reduced shares outstanding through share buybacks saw

their stocks, on average, beat the return of the 1,000 largest stocks on U.S. exchanges (as measured by the Russell 1000 index) in 2000 by 12.5 percentage points. They maintained their lead through April, the latest data available, marking a dramatic reversal from 1999. Then investors bid up the stock prices of companies that plowed every dollar into projects to accelerate earnings growth. The stocks of companies shrinking their share counts lagged by 28 percentage points in 1999. And as the ac-

companying table shows, many companies that combined big share repurchases and high dividends have their stocks do even better.

CONVERTIBLES, TOO. Dividends, the traditional tool for distributing profits to shareholders, command new respect from investors for the first time in years. High-dividend-yield stocks, such as utilities, oil companies, and real estate investment trusts, have been the best performers since last year's stock bust, notes Richard E. Cramer, market strategist at Legg Mason. His firm interviewed its investors during the market downturn and found them craving steady payouts. The sentiment, he says, is also reflected by a record sales of convertible securities, which pay interest but can be changed for stock. Says Galbraith, "Dividends have returned to a market where returns are king."

That sounds like hyperbole to Edward P. Hemmelgarn, chief investment officer at Shaker Investment

Management. "I have no doubts investors prefer stocks that have really climbed all that much in the last few years of the decline of the stock market. That's why the growth was so high. The result is that investors are trading out of growth stocks before they fell further, and investors are shifting toward safety of

HIGH YIELD, HIGH RETURN

These companies returned piles of cash to shareholders through buybacks and dividends

COMPANY	CASH PAYOUTS AS PERCENT OF MARKET CAP*	12-MONTH PRICE CHANGE**	COMPANY	CASH PAYOUTS AS PERCENT OF MARKETCAP*	12-MONTH PRICE CHANGE**
SIGMA-ALDRICH	19.2%	42.7%	KB HOME	9.2%	46.2%
BURLINGTON NORTHERN	13.1	30.8	KNIGHT RIDDER	9.0	2.4
WHIRLPDOL	12.7	10.9	NUCOR	8.2	31.6
DILLARD'S	12.4	8.6	FORTUNE BRANDS	7.7	29.4
MAY DEPARTMENT STORES	10.4	8.8	BALL	7.6	58.0

*One year of dividends and repurchases as percent of market capitalization

Data: Morgan Stanley Dean Witter & Co., BusinessWeek

**Through May 2001

like investments when the economy and stocks falter, adds James W. Jensen, chief investment officer at Capital Management.

At this time the new attitude toward buybacks and dividends may last long while, even if the stock market rises gradually from here. "Companies may opt to pay out more of their earnings" through buybacks and dividends because they don't have any better to do with the money, says Jensen.

ANTAGONISM. Several factors are driving down returns on corporate investment: high energy costs, price pressure from competitors, and, most important, the recent passage of a running capital investment boom. The boom already snared the best opportunities and productivity. Richard Jandrain, chief equity investment officer at Banc One Investment Advisors, says institutional investors now expect managements to be spending on technology, a switch from the recent past when tech spending was assumed to be worthwhile, if essential. Richard Hoey, chief economist at Dreyfus Corp., says the past brought new antagonism between investors and managers over allocation of capital.

Yet there are signs that the friction is giving way to agreement between investors and investors that more capital spending should be deferred. Tobias Levkovich, stock strategist at Salomon Barney, says a financial-services company manager recently described how he could lift this year's profit margin by deferring planned capital spending on technology. Levkovich took over, checked financial reports from a range of companies, and concluded that, on average, companies can boost earnings by 1% to 2% by cutting information-technology spending by 10%. Potential savings comes from reducing the rapid depreciation charges and the time cost of software and employee training that come with the new technology. That may not sound like a lot of savings, but it is a lot when companies are struggling to meet earnings estimates.

For investors, the message is not to stick to the tech stocks that are driving growing capital spending. Instead, they should continue to favor companies whose returns through dividends and stock buybacks are more certain. More investors follow that advice, and companies will have a stronger incentive to forgo expensive tech projects that would delay the capital market bounce-back even longer.

*By David Henry
in New York*

COMMENTARY

By Christopher H. Schmitt

IPOs: HOW WALL STREET CAN GIVE EVERYBODY A CHANCE

The securities industry likes to brag that U.S. stock markets are the best and fairest in the world. But to many investors, that boast had a hollow ring during the initial public offering bonanza that began in the mid-1990s and ultimately saw more than 2,800 companies raise more than \$270 billion. Investors reaped much of the profits,

also move to clean up the IPO business. That way, they can make sure that in the future IPOs are fair to all investors, not just a select few.

COMMISSIONS: TOO HIGH? Wall Street firms are at center stage because of how the IPO market works. They buy stock from a company and then sell it to investors, such as mutual funds, hedge



and individual investors were too often locked out.

Today, investigators are probing whether Wall Street bankers essentially demanded kickbacks in exchange for allocations of hot IPO stocks. An early focus of the investigations, by the Securities & Exchange Commission, the U.S. Attorney's Office in New York, and the National Association of Securities Dealers, has been Credit Suisse First Boston, though at least half a dozen more firms are being investigated. CSFB has acknowledged it has been questioned but says that what it did was in line with standard industry practice.

ON THE HUNT. Regulators and the Justice Dept. may have trouble bringing charges because existing rules covering any alleged abuses they turn up don't apply specifically to superheated IPOs. So while the authorities hunt for ironclad evidence of misconduct, they should

FRENZY

It's hard to keep order when so many investors want in

funds, or wealthy individuals. When IPO stocks are rocketing after hitting the market, the firms become financial kingmakers, be-

cause they decide who gets to ride along. This was especially true at the peak of the IPO boom. Many companies saw their stock prices double on the first day of trading, with the biggest one-day gain—on shares of VA Linux Systems Inc.—topping 695%.

The probes under way focus on whether Wall Street firms, eyeing those fat gains, threw their weight around to get a cut for themselves. One major question investigators are trying to nail down is whether Wall Street forced investors to agree to pay abnormally high commissions on later transactions in return for getting hot IPO shares. Another is whether firms required that investors getting IPO shares agree to buy more shares—or not sell them—once trading began in

CONTINUED FROM PAGE 11

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Underwriters should disclose how they parcel out the shares of the companies they take public

order to shore up stock prices.

On paper, the investigators seem to have plenty of legal ammunition on hand to attack abuses they uncover. An NASD rule dating back to 1943, for example, outlaws excess commissions; another bars unreasonable compensation. Companies must also disclose in reports to the SEC how much they pay in fees to Wall Street firms for IPOs. In principle, each IPO must be widely available to the public, not just a handful of favored customers. And long-standing safeguards intended to prevent market manipulation apply to trading in IPO shares after they're in the hands of the public.

The trouble is most of these rules are vaguely worded. That on excessive commissions, for example, speaks of "fair" prices depending on market conditions. So regulators may have to rely heavily on catch-all rules, which allow regulators to cast a wide net. The NASD, for instance, frequently disciplines members who fail to "observe high standards of commercial honor and just and equitable principles of trade." The SEC requires securities firms to document virtually everything they do. If they haven't a complete paper trail in the IPO cases, they're vulnerable.

TOUGH LINK. Clearly, there's enough ambiguity in the rules to make enforcement cases shaky. For starters, investigators would have to prove that payments or arrangements were made specifically to obtain IPO shares. Making such a link is never easy. Then there's interpretation. Consider the question of high commissions on later trades with investment banks in

order to obtain IPO shares. To an ordinary person, that smells like a kickback. But legally, it's not that obvious. "In the most benign sense, it would be compensation for the opportunity to participate in an offering not otherwise available," says Leo F. Orenstein, a Washington securities lawyer and former SEC enforcement official. "It's not altogether clear [that it is illegal]."

Lawyers also worry that rules not designed to cover IPOs would be

and another former SEC official. "Why would we want to restrain our own markets and lessen our flexibility?" But if—as Wall Street pros often say—the bedrock of the markets is investor confidence, the more needs to be done.

RIGHT TO KNOW. A minimum first step must be to ban both kickbacks in the form of higher commissions and requirements to buy more shares to pump up prices once tra-



CREDIT SUISSE: The bank has been an early focus of the investigations

stretched too far. And they may have a point. "It's not fair to bring an enforcement case if you don't have clear standards," says Richard Roberts, an SEC commissioner from 1990 to 1995 who is now with a Washington law firm.

Of all the practices under scrutiny, the post-offering buy and sell arrangements have received the most recent attention from regulators. SEC legal staffers specifically reiterated last year that making customers buy extra shares was prohibited. But that admonition came long after the boom began, and then only as an advisory.

Securities insiders caution against a rush to new regulation. "The American capital markets are the wonder of the world," says Charles Snow, a New York securities lawyer

ing begins. The NASD and the New York Stock Exchange can do that quickly by changing their own rules. Once that's done, a full-blown SEC rule should follow.

Investors are also entitled to know more about how investment banks parcel out the shares in IPOs. Ideally, the banks should name names and amounts. No doubt, the banks would complain about overregulation and being forced to divulge sensitive information. They may be right. But public securities markets are ultimately just that: public interest should be the driver.

Now, Wall Street has a chance to prove that its markets are the fairest and the best in the world should seize it with both hands.

With Mike McNamee
in Washington

THE RULES FOR IPOs NEED FIXING

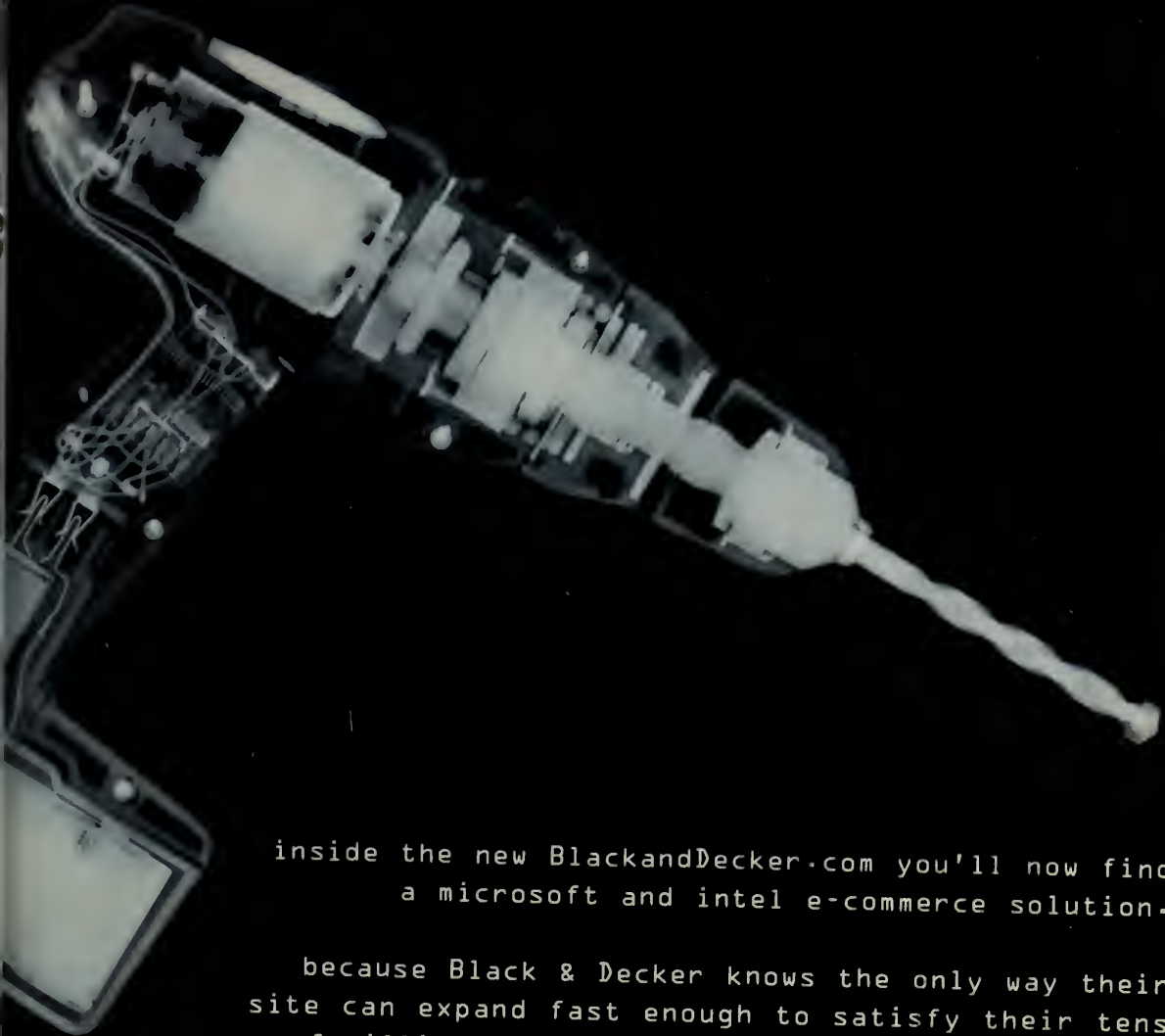
Federal and securities industry investigations into Wall Street's practices for allocating shares in hot IPOs show that stronger rules are needed

ISSUE

FIX

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|---|--|
| • Investors have to pay higher commissions on future business to secure IPO shares | • Ban the practice by rewriting general securities rules to apply specifically to IPOs |
| • Wall Street firms play favorites in doling out allocations of IPO shares | • Compel disclosure of how shares are allocated—and who gets them |
| • Underwriters require those getting IPO shares to buy more in the market to boost prices | • Make SEC guidelines advising against the practice into full-blown rules |

Data: BusinessWeek



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BANKING

WHAT'S NEXT— THE BANK OF BURGER KING?

The newest banks are also carmakers, retailers, universities

When BMW owner Jason E. Bledsoe got a letter from the carmaker offering the "ultimate in banking" through its new online bank, the Little Rock information technology consultant leaped at the offer. Dissatisfied with his traditional bank, he closed his savings account there and opened checking and money-market accounts with BMW Bank of North America. And for the past 11 months, he has been happy with the snappy service and easy Net access.

Bledsoe is just the kind of client that a motley array of car companies, retailers, and even universities are seeking to leverage their brand names—and customer lists—by setting up their own Internet banks, mostly from scratch. Retailers such as Nordstrom and Macy's owner Federated Department Stores are in the game, along with Volkswagen, General Motors, DePaul University, and Drexel University. They began diving into banking in the spring of 2000, after deregulation opened the way. Nordstrom, for instance, obtained a thrift charter for its preexisting Nordstrom National Credit Bank. Now they're all purveying credit cards and loans as well as checking and savings accounts. Drexel even offers stock-trading through Philadelphia brokerage Cohen Bros. & Co. to its students.

Why are upscale carmakers and retailers surging into the business? BMW, for one, figures that having an actual bank, rather than just the credit unit it had before, gives it a cheaper way to raise capital for its credit business than the debt markets. It has access to deposi-



CASH AND CARRY: A shopper uses a Nordstrom ATM in a Seattle mall

tor funds and can borrow from other banks at low federal funds rates, says John M. Christman, head of BMW financial services for the Americas. Since July, 2000, when the bank opened, Christman has signed up 25,000 customers with \$1 billion in assets, and the bank is now operating profitably. Retailers hope to run credit-card operations without having to split profits with outsiders. And a federal

bank charter would let such outfits as General Motors Acceptance Corp. override state usury laws and charge higher uniform interest rates nationwide.

But it's far from clear that the new breed of bankers can escape the ills afflicting the pros. Many Net banks are struggling to make profits. Bank-owned credit-card opera-

tions are scrambling to gain mass through consolidation, such as Bank One Corp.'s purchase of Wachovia Corp.'s credit-card portfolio. And expertise in retailing or automobile doesn't guarantee success in broad banking services. Retailer J.C. Penney Co., for example, left the credit-card business in frustration early this year. "How could you expect a retailer's management to understand the intense competitive financial-services industry?"

asks Kenneth A. Posner, a specialty finance analyst at Morgan Stanley Dean Witter. **A HEADSTART?** Still, the newcomers figure they have special skills and assets. They have a captive customer base, built-in brand loyalty. So unlike other Net banks, they don't have to spend big to establish names. What's more, their customers already turn to them for credit services. "Our superior service banking will enhance the relationship," argues Michael Knight, executive vice-president at Nordstrom Federal Savings Bank, which now has 5 million customers and has made money from the get-go.

The risk is that these new bankers could tarnish their precious brand names if they fail to deliver on their bank promises. Workers at customer call-centers used to deal with hassles over car lease credit-card overdrafts could find it hard to become full-service phone tellers. Warns

Rajendra, vice-president for innovation at EDS Financial Services Group in New York: "Poorly delivered customer service from inept reps would just annoy and irritate customers and could end up hurting their core brand."

And big brand name or not, old habits die hard. Most people still prefer to deal with traditional banks. A survey by the Bank Administration Institute of Chicago shows that customers overwhelmingly want a branch close by and the ability to talk to a representative in person—something most new banks are not providing.

No matter how well-known the brand on which the new banks are built might be, their success will depend on how comfortable people are with handing over their life savings to their carmaker or to the stores where they shop. Consumers may feel such outfits are too big a call on their wallets already.

By Pallavi Gogoi in Chicago

A NEW BREED OF BANKER

A growing number of nonfinancial outfits are opening their own banks

NAME	START DATE
NORDSTROM	Mar. 2000
FEDERATED DEPT. STORES	Mar. 2000
BMW	Jul. 2000
DREXEL UNIVERSITY	Nov. 2000
DEPAUL UNIVERSITY	Jan. 2001
VOLKSWAGEN	Awaiting approval
GENERAL MOTORS	Awaiting approval

Data: BusinessWeek



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Digital Cameras Th

BusinessWeek Lifestyle



BY LARRY ARMSTRONG

You would think camera makers could come up with a decent digital point-and-shoot camera. After all, they've been turning out stylish, simple-to-use film cameras for decades, under-\$200 numbers for folks who just want to take a few snapshots now and then and don't want to bother with such mysteries as f-stops or white balance.

Sadly, most digital cameras would still befuddle the average shutterbug. I learned this when I set out recently to find a good, relatively inexpensive digital camera that I could use right out of the box. By "use," I mean not only take snapshots but also transfer the pictures to a computer where I could print them out myself or upload them to a photo-processing Web site that would mail me the prints. My ground rules: The camera had to be priced under \$300, and the images it took had to have a resolution of at least 1 megapixel, or a million pixels, the tiny dots of color that make up the picture. That's the minimum you need to get a satisfying 4x6-inch print. Twice that and you'll get wonderful 8x10-in. glossies, suitable for framing.

I looked at a half-dozen popular brands. Only two cameras truly measured up: Hewlett-Packard's \$299 Photosmart 315 and Kodak's \$299 DX3500. The Photosmart's bargain 2.1-megapixel resolution and ease of use made it the best-selling camera—film or digital—last Christmas. Kodak's product is the entry-level model in its brand-new EasyShare series, a line of cameras that fit into an optional \$79 docking station that stays permanently connected to your computer. I'd recom-

HP PHOTOSMART 315

STREET PRICE \$299
2.1 MEGAPIXELS

A stripped-down but best-selling basic camera; by far the best software for downloading, printing, e-mailing pictures

mend any of the other models I tried—with an important caveat: You must know your way around your computer or be prepared to call the camera maker's tech support staff for help.

Digital cameras have some very compelling advantages. By and large, even the most expensive digitals have an automatic mode that takes over such chores as focusing on the subject and setting the appropriate light exposure. That means you can pick up almost any digital camera and get a decent shot.

SNEAK PREVIEW. On the advanced models, you can use manual settings to match your shooting conditions exactly. As you move down the line from professional to amateur cameras, the usual operating choices become fewer and fewer. Still, on most of the cameras I looked at (though not my two top picks), you could choose the exposure to compensate for overly bright outdoor shots, such as beach scenes, and underexposed indoor shots, such as the white balance on indoor lights to offset incandescent or fluorescent lights.

Digitals have an electronic viewfinder on the back, so unlike with film cameras, you can see a sneak preview of what you're shooting. You can delete mistakes before they happen. You can see them or before you pay to have them developed. And you can get your snapshots immediately, without waiting for an occasion to fill the roll before you get them developed.

The problem I found wasn't so much with the cameras themselves but the software that comes with them. Despite the USB port on all new cameras that's supposed to make digital camera plug-and-play, most camera makers haven't figured out how to make transparent the pro-

KODAK DX3500

STREET PRICE \$299
2.3 MEGAPIXELS

First in a line designed for amateur use, easy-to-use software, optional \$79 docking station, good choice for beginners

Cameras

You Can Afford

What matters: A high megapixel count and easy-to-use software



SHOT
30
CE \$299
PIXELS
with
such as
effects
rie
3X zoom
kes up
n

transferring images to your PC. My favorite camera was the Olympus Brio D-100, the first of a new, supposedly easy-to-use line. It's lightweight, just 7.2 ounces with batteries, and small enough to fit into a shirt pocket. But the company's Camedia software hasn't caught up to today's technology. Even when the camera is hooked up correctly, if you click on "My Camera"—the logical place to look for your pictures, right?—you'll get an error message saying that the software can't find

mera. It's there all right. Like all USBs, if you click on Windows Explorer or My Computer, you'll find the camera listed as an external hard drive.

wise, the software for Sony's Cyber-shot installed beautifully, but I had to figure it out myself. An incredible goof: One menu choice is "from a Sanyo camera," and various addenda instruct you where your pictures are, but the picture retrieval software that comes with the camera is an incredible goof: One menu choice is "from a Sanyo camera," and there's no similar option for Sony cameras.

INTERVIEW. It took Hewlett-Packard to make a user-friendly camera. The software in the HP Smart 315 loads without a hitch—and without annoying questions from your computer about where to look for the camera's dried-out or related geek-speak. Once it's installed in a five-minute job, every time you plug in the camera, an HP program automatically opens up so you transfer pictures and view, edit, or e-mail them.

The camera's design is clean and simple, a tad bulky—at 12.1 ounces, it is 2 oz. heavier than the next heaviest, the Fujifilm

OLYMPUS BRIO D-100

STREET PRICE \$249

1.3 MEGAPIXELS

The smallest and lightest of the bunch is a true shirt-pocket camera; carry extra batteries to compensate for high power consumption

FinePix. Like the others, it has an optical viewfinder in addition to the electronic display, but it alone has a tiny LCD status screen like those on film cameras. It shows the settings for resolution, flash, pictures remaining, and battery life instead of cluttering up the color display with icons. Buttons on the camera body let you change most settings without turning on the color display and drilling through menus, a battery drain.

The Kodak model features simple controls and an almost identical approach to the software. Its docking station is a useful accessory that recharges the camera's battery when it's not transferring shots to the computer. But the camera works fine without it. Whatever camera you buy, pick up a set of fast-charge NiMH batteries and an external charger for about \$35 or \$40. These cameras use AA batteries and burn them quickly.

Another tip: Each camera has a "digital zoom" feature; use it sparingly. While that can help you compose the perfect shot, it simply blows up the center of the picture and could cost you the resolution you need to get good prints. If zoom is a must-have for you, you need to get a camera with an optical zoom lens, such as the Sony or the step-up version of the Olympus, the Brio Zoom D-150. That one costs about \$70 more.

Someday, perhaps even later this year, all digital cameras will be as simple as the HP and Kodak. But for now, there are few options for those who think that getting digital snapshots ought to be fun, not a puzzle or a chore. □

FUJIFILM FINEPIX 2300

STREET PRICE \$279

2.1 MEGAPIXELS

Good bargain choice; small menu navigation button a little difficult to use

DOCKING: The Kodak DX3500 links to your computer



Real Men Like Seaweed Body Wraps

For Father's Day, how about a visit to a spa?

BY JOSEPH WEBER

Spa Speak

AROMATIQUE

MASSAGE A rubdown with scented oils that relaxes or invigorates, depending on which oil is used.

EXFOLIATION

A scrubbing with a loofah sponge or sea salt to clear away dead cells and reveal healthier skin underneath. An important part of a facial.

ISOTHERMAL BODY WRAP

An application of muds, such as a seaweed compound, to the body, which is then wrapped in oiled plastic or foil while resting on a heated bed. Sweats out impurities.

PARAFFIN TREATMENT

A skin softening process achieved by dipping the hands or feet into hot wax, which is then stripped away.

Data: Paris Spa by Mandara, BusinessWeek

O.K., guys. Having herbal masques slathered onto your mug, encasing your hands and feet in heated mitts, and being exfoliated, detoxified, and hydrated may not sound like a good time. Maybe you get the willies thinking about essential oils, isothermal wraps, and French caviar facials. And the idea of lounging among mud-covered matrons, clad only in a robe, may send you fleeing to the steam room at the Y.

But as someone who has broken through the gender barrier, let me tell you that the ladies are on to something. After being rubbed down with sweet-smelling extracts and nutritional balms and having clays and moisturizers patted onto my face in between scrubbing sessions that left no dead cell unscathed, I became a believer. Yolanda Graham, my aesthetician at the Paris Spa by Mandara at Las Vegas' Paris hotel-casino, alternately pampered and tortured my weather-beaten skin into a baby's-bottom smoothness that even my wife envied. A spa visit, I found, is an indulgence well worth giving up even a morning of softball for—and something that would make for a novel Father's Day gift.

MANLY PLUNGE. Actually, growing numbers of guys are finding that a little pampering can help their looks—and outlook. Some 35% of the customers who visit the nation's 900 or so resort, destination, and cruise-ship spas are men, along with about 15% of those at the country's 4,400 day spas, says the International Spa Assn., an industry group. Spas have wooed guys with more gym equipment and changes in marketing: Deep-muscle "sports massages" are offered along with lighter, Swedish massages, for instance. Yes, pedicures and bikini waxes still abound, but a "men's cold plunge"—into invigorating, 55F water—now appears on some spa programs. Expansion into the male market has helped boost

visits to over 90 million a year, according to a recent study by PricewaterhouseCoopers.

Shrewdly, some spas offer package deals for couples, maybe the best kind of Father's Day gift. The Paris Spa by Mandara features a Paris Les Amoureux (Paris for Lovers) package with simultaneous full-body cleaning treatments—salt-based or other creams, followed by an aromatherapy bath (for two) in a whirlpool—and French pedicures. Then the lucky couple gets an Aromatique massage on side-by-side tables. Cost: \$225 each for two decadent hours. Want just a solo facial? Pour L'Homme, a \$100, 50-minute rejuvenation session tailored for shaving-irritated skin.

If you prefer something closer to home, look for out luxury hotels. The spa at the Park Hyatt in Chicago, for example, offers Enrichment for Men. For \$292, you get a 30-minute aromatherapy and-neck massage, an hour-long deep-tissue massage, a "reflexology" foot rub and pedicure, a dip into warmed wax, and a "sports buff-

ing" cure. To mark Father's Day, its long full-body massage will cost \$150. June 10 to June 15, that's \$50 off.

YOGA, TOO.

Spas with bigger budgets and more time to choose a destination resort. When a man pays the full price for a night stay at Canyon Ranch Health in Tucson during summer low season, a child over 12 for half-price. A child is 25% off. Along with the Dad can hike, play golf, or do a similar three-



AH, THAT'S THE RUB:
A facial at Mandara

deal at Canyon Ranch in Lenox, Mass., costs \$1,566. "You can work out every day," says Goodes, the former chief executive of V.L. Lambert Co. who frequents the Tucson spa with his adult children and wife, Nancy. Goodes' fesses up to the occasional facial, with his wife coaxing. Another spot, Rancho La Puente, Tecate, Mexico, offers special couples' week-long packages, five times a year, for \$1,900 to \$2,850 a person.

To search for a spa, check out www.enceispa.com, the official site of the International Spa Assn. You can search by geographic location, such categories as "day spa" or "resort." Look, too, at www.dayspaassociation.com, the site of the Day Spa Assn. Links can bring you to specific spa sites, if available.

Women have warmed to spas more than men, spa managers say, because they are more comfortable being pampered. But once you've been indulged, you may find habit-forming. Seaweed facial, anyone?

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WHAT TO
LOOK OUT FOR
IN THE
TAX CODE

BusinessWeek Investor

The New Taxes: Keep a Sharp Eye on the Calendar

Breaks are substantial, but they disappear a few years out

BY MIKE McNAMEE

Washington is handing out \$1.35 trillion in tax cuts. Heirs, two-earner couples, workers saving for retirement, and parents planning for college are all winners under the tax bill championed by President Bush and passed by Congress. You'd hardly think there could be a downside.

But for financial planning, the measure is a mess. "I feel as if I need a calliope playing—Congress was acting like a circus," says Thomas Ochenschlager, director of federal taxes for accountants Grant Thornton. A carnival may be more like it, because many of these tax cuts are like the pea in the huckster's shell game—now you see them, now you don't. Pieces of the bill phase in, then phase out. And in a breathtaking budgetary sleight-of-hand, Congress decided that the entire tax law will "sunset" in 2011—bringing back today's tax rates and estate-tax system.

So, planning your finances for the next decade requires a leap of faith: You've got to believe that future Congresses will renew the tax-cut riots that today's lawmakers wrote. "People have a right to plan ahead and know what the law will be," grouses George Cushing, an estate attorney with Day, Berry & Howard in Boston. Such certainty may be out of reach—but for now, at least, here's what the law says:

■ **RATE CUTS.** The bill immediately creates a new 10% tax bracket, down from 15%, on a couple's first \$12,000 in taxable income (\$6,000 for single filers)—worth \$600 in savings for a couple. Higher brackets are cut in 2001, 2002, 2004, and 2006. By then, today's 28%, 31%, and 36% rates will have been cut by 3 percentage points, and the top 39.6% rate will have fallen to 35%.

The message is clear: If you can put off collecting income, you'll pay less tax. "My clients who were considering deferred compensation programs are finding a lot more urgency now," says Martin Nissenbaum, director of personal taxes for accountants Ernst & Young. You'll also

want to prepay next year's deductible expenses such as real estate tax or professional subscriptions—because they're worth more in 2001.

■ **EDUCATION SAVINGS.** For parents, the tax bill is "the gift of a lifetime," says Miller of College Solutions, an Alameda (Calif.) planning firm. The biggest gift: If you've set up a "529 plan"—a prepaid tuition account or a sponsored savings plan—neither you nor your kids will owe any tax when those funds are withdrawn to pay college expenses, after 2001. Under current law, such withdrawals are taxed at the student's tax rate.

The Tax-Cut Timeline

	CURRENT LAW	2001	2002
Lifetime Exemption	\$675,000	\$675,000	\$1 million
Top rate	55%	55%	50%
Exemption for couples	\$45,000	\$49,000	\$49,000
Bottom bracket	15%	10%	10%
Top bracket	39.6%	39.1%	38.6%

The new law also boosts the amount you can contribute to a child's Education IRA, from \$500 a year to \$2,000, as of next year. Couples with income up to \$220,000—vs. the \$160,000 cap in current law—will be eligible to set up E-IRAs. Funds from E-IRAs will get tax-free treatment, whether they're used for college expenses or to pay for private elementary and secondary schools.

With these new breaks for saving, there's no reason for anyone to set up "UTMAs or UGMAs," custodial accounts in a child's name that many parents use to reduce taxes on college funds, says Miller. Either an E-IRA or a 529 plan lets the parent keep control and redirect funds to another child if the first beneficiary heads for Motorcycle U. Instead of a 529, most parents will favor 529s because they can be far larger—up to \$250,000 in some states—but E-IRAs give more control over how funds are invested, Miller says.

The new law also adds a tuition deduction, even for taxpayers who don't itemize.

Starting next year, couples with incomes up to \$130,000 can

deduct up to \$3,000 a year in college expenses; in 2004, the limit rises to \$4,000. (In 2006, the deduction disappears.) The HOPE and Lifetime Learning credits are worth more than these deductions, but they phase out for parents with incomes over \$80,000. The new law also increases deductions for student-loan interest.

Taxes

■ **RETIREMENT SAVINGS.** Individual retirement accounts can be richer under the new law. The ceiling on tax-deductible contributions, stuck at

\$2,000 since 1982, will rise to \$5,000 by 2008.

Employer-backed nest eggs can also grow. A worker with a 401(k) plan can save at most \$10,500 of pretax income today; the new law increases that to \$15,000 by 2006. (Similar plans offered by nonprofit and governmental employers will also enjoy increases.)

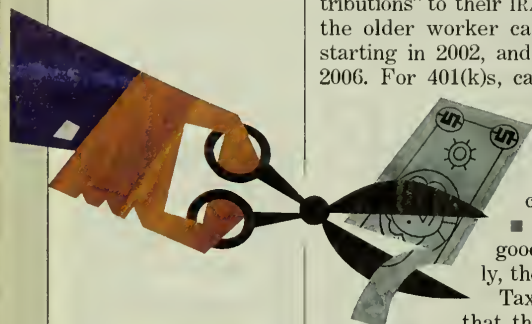
Starting in 2006, you can use part of your 401(k) contributions to create a Roth 401(k), modeled on the popular Roth IRA. You won't get a tax break for contributions, but all your withdrawals will be tax-free. That could be good news for your heirs, because future generations can inherit a Roth account and let it grow without income tax.

A provision designed to help women who take time out of the workforce can boost men's savings, too. Starting next year, all workers 50

Smart investors will start keeping detailed records of the prices they pay, especially for hard-to-value assets such as partnership shares or investments in family businesses



2005	2006	2007	2008	2009	2010	2011
Estate & Gift Tax						
\$1.5 million	\$2 million	\$2 million	\$2 million	\$3.5 million	Estate tax repealed	\$1 million exemption restored
47%	46%	45%	45%	45%	0%	55%
Charitable Minimum Tax						
\$45,000	\$45,000	\$45,000	\$45,000	\$45,000	\$45,000	\$45,000
Rate Cuts						
10%	10%	10%	10%	10%	10%	15%
37.6%	35.0%	35.0%	35.0%	35.0%	35.0%	39.6%



Starting next year, workers 50 years and older can make "catch-up contributions" ranging from \$500 to \$5,000 a year to their retirement accounts

years or older can make tax-free "catch-up contributions" to their IRAs and 401(k)s. For an IRA, the older worker can add up to \$500 a year starting in 2002, and \$1,000 a year starting in 2006. For 401(k)s, catch-ups start at \$1,000

in 2002 and increase to \$5,000 in 2006. Employers can match these extra contributions if they choose.

■ **ESTATE PLANNING.** The good news is, slowly but surely, the estate tax is going away. Tax publishers RIA calculate that the tax on a \$10 million estate will fall from \$4.92 million if the owner dies this year, to \$2.93 million for a death in 2009, and to zero in 2010. The bad news: The very next year, the estate tax returns—with today's top rate of 55%. The tax on a \$10 million estate will then shoot back to \$4.8 million.

Needless to say, planners are fuming. "It's very bizarre tax policy," says Randi Schuster, head of family wealth planning for accountants BDO Seidman. Odds are that Congress will eventually enact something like the 2009 estate tax—with the first \$3.5 million in an estate exempted from tax and a top rate of 45%—as the permanent system. For now, estate experts say you should:

■ **Check your will and trusts.** Most estate plans direct assets into two trusts. The "bypass" or "credit-shelter" trust gets enough assets to use up the estate tax's unified credit, which is now \$675,000, and is set up to benefit the owner's children. The rest of the estate goes into a marital trust for the spouse.

The new law boosts the unified credit to \$1 million next year, and to \$3.5 million by 2009. For an estate of \$5 million, the standard estate plan means the spouse's inheritance would fall from \$4.35 million this year to \$1.5 million in 2009. "You run the risk of leaving your spouse without sufficient resources," says Schuster, "especially if it's a second marriage" and children from the first union won't share with their step-parent. Wills should be written with a cap—either a dollar figure or a percentage of the estate—on the children's credit-shelter trust.

■ **Make gifts.** 'Tis better to give than to bequeath, because the tax you'll pay on a gift is less than the tax your heirs will pay on their inheritance. With the estate tax here for at least nine more years, it makes sense to give away property. Gifts of assets likely to appreciate—hot stocks or

stakes in privately held companies—are the for tax-cutting.

■ **Watch your statehouse.** The estate-tax provisions will cost states \$6 billion in annual revenue. States are likely to respond with new taxes on estates that will complicate your will.

■ **Keep records.** Under the estate tax, heirs break on capital gains: They can value assets as of the owner's date of death and only pay taxes on capital gains that occur after that. In 2010, when the estate tax is repealed, this "stepped-up basis" disappears (only to reappear along with the estate tax in 2011). Then, heirs who sell inherited assets will owe taxes on all gains from the asset's original purchase price. (The law exempts \$1 million in gains for each estate; spouses can exempt an additional \$3 million.)

This accounting nightmare won't take off unless the estate tax is permanently repealed, which seems unlikely. Still, smart investors should start keeping detailed records on the prices paid, especially for hard-to-value assets such as partnership shares or family businesses.

■ **AMT RELIEF.** Nothing better illustrates the tax bill's wallet-on-a-string tricks than the alternative minimum tax relief provision. The

Tax Tips for The New Era

POSTPONE INCOME With rates falling, deferred compensation will face lighter taxes

SAVE FOR COLLEGE State-backed "529 plans" and education IRAs get new breaks

BOOST YOUR PENSION Higher savings limits for 401(k)s and IRAs, plus new Roth 401(k), help your nest egg grow

CHECK YOUR WILL Higher exemptions for estate taxes may tilt your bequests out of balance

GIVE GIFTS people can make bigger tax-free gifts

STAY ALERT New law's phase-ins and phase-outs mean uncertainty for your finances

is a parallel code designed to limit use of shelters and credits. If such breaks reduce your taxes too much, you're forced to recalculate your return without several key deductions, including those for state and local taxes. The AMT is catching up, and more middle-income taxpayers will lie, and the new tax bill expands the AMT trap by adding ordinary taxes without changing the AMT minimums.

Congress tried to reduce the number of taxpayers caught in this web by raising the amount of income exempt from AMT—from \$45,000 to \$50,000 for couples, and from \$33,000 to \$35,750 for singles—effective this year. If you've been subject to the AMT, check with your accountant now. The extra income may let you skip some steps you might have planned to avoid the AMT, such as timing off state tax payments.

The relief only lasts through 2004; by 2010, the new law will double the number of taxpayers subject to the AMT,

million. Clearly, today's lawmakers are passing this problem to future Congresses.

There's the rub. The tax bill's many appealing features—lower tax rates, relief for two-income couples, aid for retirement and college savings—come with an acid edge of uncertainty. Enjoy the tax breaks, but keep your financial planner's phone number handy. You'll need it in years to come.

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DIVORCE COURT 2001



BY TODDI GUTNER

hers@businessweek.com

In cases where the higher-income partner is the ex-wife, the court may assume that the father is primary caregiver and thus merits compensation

I recently spoke with a managing partner of a large law firm in New York City who is anxiously awaiting the financial verdict on her divorce case. Not only is she the family's primary breadwinner, but she also has been the parent who has taken the most responsibility for the couple's three children throughout her 20-year marriage.

Aside from the distribution of marital assets, the court will decide how much the woman must pay her ex-husband in alimony. While divorce laws differ by state, "the courts are increasingly willing to award alimony to men, even though it goes against legal and social traditions," says Sally Goldfarb, a law professor at Rutgers University School of Law in Camden, N.J., who specializes in family law and women's rights.

What you may not know is that alimony is based not only on economic need but also on a spouse's role in managing the household affairs. (Other, lesser considerations include the duration of the marriage and ability to pay.) The law assumes that by taking care of the family, a stay-at-home or lower-earning spouse helps the higher-income partner achieve success. Sometimes, however, an inequity arises when the wife is the main breadwinner and has to pay alimony to her ex-husband. It's calculated on the mistaken assumption that the traditional roles have been reversed and the man has primary responsibility for the household and care of the children.

Economic need is relatively easy to determine. Basically, the law allows for both spouses to retain their standard of living after a divorce. Since two households are more expensive than one to maintain, a typical way the courts strive for equity is by requiring an equal decline in both parties' standard of living.

The real difficulty surrounds the issue of contribution to the family. "Traditionally, alimony has been awarded to a stay-at-home parent, usually the woman, who becomes economically dependent because she is raising the family and running the home life," says Patricia Barbarito, head of the matrimonial department of the Denville, N.J., law firm Einhorn, Harris, Ascher, Barbarito, Frost & Ironson.

In families where the wife brings in most of the income, some husbands do act as "Mr. Mom," but they are few and far between. A study by sociologist Arlie Hochschild and published in her 1997 paperback, *The Second Shift* (Doubleday, \$13.50), found that 80% of all women in dual-income couples do the lion's share of housework. Says attorney Barbarito: "These professional women haven't been assisted on the home front, and yet they still need to pay alimony" on the basis of the man's contribution to the household.

CLEAN CLOTHES. One of Barbarito's clients is a high-earning female executive in New Jersey who was responsible under state law to pay permanent alimony to her husband when their 10-year marriage ended. The court clearly said that, on economic need, since the husband's standard of living would be adversely affected by the divorce. But since the wife took charge of the child-raising duties, the court ruled against her.

Barbarito succeeded in limiting alimony to \$1,000 a year for five years. A portion of those payments still counted for the husband's more limited contribution to the family.

So what can be done about this? The law says that a man cannot make an automatic assumption that every husband, or wife, who remains at home or has a lower-paying job functions as a primary caregiver. Judges and lawyers must examine which spouse is actually performing such domestic duties as taking the children to the doctor, arranging



dates and child care, and making sure there's food in the refrigerator and clean clothes in the closet. Then, an economic value must be placed on those duties. Both need and contribution must come into play in the alimony decision, says Rutgers' Goldfarb, "which suggests that a spouse who has one and the other should receive less alimony than one who has both."

For financially successful women about to tie the knot, a prenuptial agreement may be a way to go. Unfortunately, the divorcing law partner I spoke with didn't consider prenup 20 years ago. It is certainly on her screen now.

BusinessWeek online

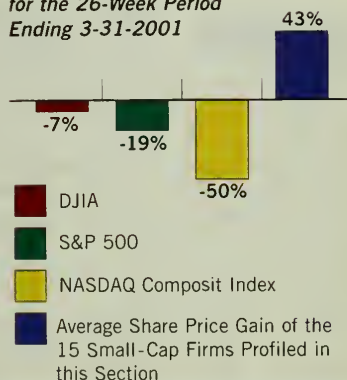
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THE EQUITY INVESTOR'S 26-WEEK SMALL-CAP REVIEW

SELECTED PROFILES OF THE NATION'S TOP PRICE-PERFORMING SMALL-CAP COMPANIES AS OF 3/31/01

of approximately 1,700 domestic companies with market capitalizations of 200 million to one billion dollars, the following profiles highlight selected top-ranking firms, in terms of share price performance for the 26-week period ending 3/31/01. Each profile describes a leading company including its industry, market trends and reasons for success, as written by company management. While past performance is never a guarantee of future results, these top-performing companies represent investment opportunities worthy of a small-cap investor's close consideration.

Annualized Gain/Loss
for the 26-Week Period
Ending 3-31-2001



Seitel, Inc. • SEI • Seismic Data

Houston, TX • IR Contact: Russell Hoffman • 713-881-8900
www.seitel-inc.com

EL SOLUTIONS
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Local Financial Corporation • LFIN • Banking

Oklahoma City, OK • IR Contact: Richard L. Park • 405-841-2298
www.localok.com



	Year 2000	1st Qtr. 2001
Inc. Before Extraordinary Item	\$24.7 Mil.	\$6.8 Mil.
Basic EPS	\$1.20	\$0.33
R.O.E.	17.85%	17.26%
R.O.A.	1.04%	1.09%

Local Financial Corporation, a \$2.6 billion holding company for

Local Oklahoma Bank, the third largest commercial bank based in Oklahoma, has 51 branches serving 33 communities statewide. Deposits are concentrated in the major markets of Oklahoma City, Tulsa, and Lawton.

Oklahoma's diversified economy presents significant growth opportunities for the Bank which has assembled a group of commercial lending officers who bring with them many years of lending experience as well as loyal customer relationships.

Current management arrived in late 1997 and has doubled total loans and transaction deposits, while growth in book value per share has averaged 22.6% over the three year period.

Key Manager Statement

"We will never lose sight of our primary responsibility which is the enhancement of shareholder value."

Edward A. Townsend, CEO

Corporation • TALX • Business Services ASP

St. Louis, MO • IR Contact: Linda Ensor • 314-214-7239
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Key Manager Statement

"We've completed the strategic shift of our business model to one with a highly predictable revenue stream. Over the past 10 quarters we've achieved 50% earnings growth on a quarter over quarter basis. We have a unique niche in the marketplace. The Work Number has 45 million employee payroll records under contract from more than 650 clients nationwide. We expect continued strong earnings growth in the coming year."

William Canfield,
President & CEO

R.H. Donnelley Corporation • RHD • Media Services

Purchase, NY • IR Contact: Frank Colarusso • 914-933-3178
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Key Manager Statement

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Frank R. Noonan, Chairman &
Chief Executive Officer

THE EQUITY INVESTOR'S 26-WEEK SMALL-CAP REVIEW

Borland Software Corp. • BURL • Software

Scotts Valley, CA • IR Contact: Lynne Farris • 831-431-1868
www.borland.com

Borland

Borland is a leading provider of high-performance e-business implementation platform solutions designed to increase developer productivity and reduce time to market for enterprise software projects. Borland offers products in all three phases of the e-business implementation process: development, deployment and management, and a description of those products can be found at www.borland.com/products. For Q1 2001, revenues rose 11% to \$51.7 million, and net income advanced to \$5.9 million or \$0.08 per diluted share — this represents Borland's fourth consecutive quarter of profitability. At quarter-end, Borland had more than \$264 million in cash and cash equivalents.

Key Manager Statement

"We believe that our financial position provides us with the strength and financial flexibility we need to meet our customers' needs now and over the long haul."

Fred Ball, CFO

Quarter Ended	3/31/01	3/31/00
Revenues	\$51.7	\$46.5
Net Income (loss)	\$5.9	\$(1.1)
EPS (loss)	\$0.08	\$(0.02)

(in millions, except per share data)

Ohio Casualty Corporation • OCAS • P&C Insurance

Fairfield, OH • IR Contact: Dennis McDaniel • 800-843-6446 Ext. 2197
www.ocas.com

Ohio Casualty Corporation is the holding company of The Ohio Casualty Insurance Company, flagship company of six property-casualty subsidiaries making up Ohio Casualty Group (OCG). The Ohio Casualty Insurance Company was founded in 1919 and is licensed in 49 states. OCG is ranked 36th among U.S. property/casualty insurance groups based on its \$1.5 billion net premiums written (Best's Review, July 2000). Its member companies write auto, home and business insurance, marketing their products through independent agencies. Ohio Casualty Corporation trades on the NASDAQ Stock Market under the symbol OCAS and has assets of approximately \$4.49 billion (Dec. 31, 2000).

Key Manager Statement

"We place a high value on service to policyholders and have a long-standing, solid agency franchise. We recently reorganized our management structure for increased accountability and are executing a new strategic plan aimed at producing competitive returns for shareholders."

Dan Carmichael, CPCU,
President & CEO

Albany International Corp. • AIN • Paper & Forest Products

Albany, NY • IR Contact: Kenneth C. Pulver • 518-445-2214
www.albint.com

ALBANY INTERNATIONAL

Albany International supplies the world-wide pulp and paper industry, as well as other process industries with technologically sophisticated structured materials. With 6900 employees, the company has plants in 15 countries and is the world's largest producer of custom-designed engineered fabrics, that are essential to the papermaking process. Strategic diversification and growth are also pursued in areas of related core competencies, where product innovation and technology are industry drivers.

Key Manager Statement

"Our vision for 2001 begins with the recognition of the Company's strong fundamental values, our history of innovation, and an awareness of the untapped creative potential of our employees. It is clear we must bring value to our customers and shareholders by continuing to provide world-class products and solutions that meet their needs. We are confident that our plans will allow us to exceed the expectations of our customers and shareholders."

Frank R. Schmeler, Chairman &
Chief Executive Officer

Arch Chemicals, Inc. • ARJ • Chemicals

Norwalk, CT • IR Contact: Mark E. Faford • 203-229-2654
www.archchemicals.com

ARCH

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Key Manager Statement

"Our industry is undergoing changes — with new business models, mergers and partnerships, global expansion, and ever-increasing efficiencies being achieved through the use of IT. These changes are creating new opportunities for growth at Arch. We are focused on realizing our potential through internal strategic acquisitions and ventures, improving the efficiency of our operations and optimizing our portfolio of businesses."

Michael E. Campbell,
Chairman, President & CEO

Fair, Isaac & Company • FIC • Business Analytics

San Rafael, CA • IR Contact: Deborah McGowan • 415-492-5800
www.fairisaac.com

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Fair, Isaac is the dominant provider of credit rating, decision technology and analytic consulting services to the global credit industry, and helps businesses make over 12 billion decisions annually. Building on its core analytic expertise and data management capabilities, FIC is expanding its decision technologies to encompass CRM, account management and marketing capabilities to help companies increase sales within the Financial Services, Retail and Telecommunication industries acquire more profitable customer transactions and relationships. As a result of productivity gains from a outsourced business model, FIC saw a 49% surge in net income to \$10.7 million for Q201 ended March 31, 2001. Revenue for the period increased 11% to \$81.1 million.

Key Manager Statement

"We bring precision and insight to mission-critical business decisions. With a strong pipeline and added product innovations, we are poised for future growth."

Tom Grudnowski, CEO

First Niagara Financial Group, Inc. • FNFG • Banking

Lockport, NY • IR Contact: Christopher J. Thome • 716-625-7000
www.firstniagarafinancial.com

First Niagara Financial Group, Inc.

First Niagara Financial Group, Inc. is a diversified community bank financial services company that operates in suburban markets, several with the #1 or #2 market share, throughout Western and Central New York. Since its initial public offering in April 1998, the Company has doubled its asset size and increased net income 88%, cash dividends per share 200% and non-interest income 271%, which now represents 36% of net revenue. The Company has expanded its markets, products and services extensively through seven acquisitions, one of which has made it a leading provider of insurance agency services in Western New York.

Key Manager Statement

"We have built a foundation to become one of the leading financial services companies in our markets. We believe that with continued quality growth and a high performance and efficient operation, we can achieve our vision to become 'the first choice in financial services' and fulfill our mission to enhance shareholder value."

William E. Swan,
Chairman, President & CEO

THE EQUITY INVESTOR'S 26-WEEK SMALL-CAP REVIEW

Financial Corporation • RGFC • Financial Services

San Juan, PR • IR Contact: Víctor J. Galán • 787-756-2801

www.rgonline.com

FINANCIAL

Currently in its 29th year of operations, R&G Financial Corporation (NASDAQ: RGFC) is a diversified services company that through its wholly-owned subsidiaries, is a leader in mortgage banking, banking, and insurance activities. R&G Financial is Puerto Rico's largest mortgage loan originator and servicer, with a mortgage servicing of \$6.8 billion as of March 31, 2001. The Company's banking subsidiary, R&G Bank, is one of the fastest growing commercial banks in Puerto Rico. R&G Financial seeks long-term financial strength and profitability by increasing operating income through a variety of strategies. During the first quarter of 2001, R&G Financial registered record operating earnings of \$13.3 million, a 40% increase over the prior year's comparable quarter.

As of March 31, R&G Financial had total assets of \$3.7 billion (including bank deposits of \$3.0 billion), and stockholders' equity of \$389.5 million. R&G Financial has 60 branch offices (32 mortgage offices in Puerto Rico, 4 mortgage offices in the United States, and 24 bank branches mainly located in the northeastern sector of Puerto Rico), and had total assets under administration of \$10.5 billion.

Airgas, Inc. • ARG • Specialty Chemicals

Andover, PA • IR Contact: Melissa B. Nigro • 610-902-6206

www.airgas.com

gas

Airgas, Inc. is the largest U.S. distributor of industrial, medical and specialty gases, welding, safety and related products. Its integrated distribution network of 700 locations nationwide includes retail stores, packaged gas fill plants, specialty gas labs and distribution centers. The company also distributes industrial gases through e-Commerce, catalog and telephone channels. Airgas's strong local presence and broad range of products and services offer a competitive edge to its diversified customer base. Airgas's strategic accounts program, focused on supply-chain management, is growing rapidly as customers seek to reduce costs by consolidating purchases and outsourcing all but their core competencies.

Key Manager Statement

"We have strengthened our management team and operational focus to improve profitability and to position Airgas for future growth and performance. Our goal is to exceed \$2 billion in sales with operating margins of at least 10% by FY2005."

Peter McCausland,
Chairman & CEO

Genesco Inc. • GCO • Specialty Retail-Footwear

Memphis, TN • IR Contact: James S. Gulmi • 615-367-8325

www.genesco.com

Genesco Inc. serves unique customer lifestyles with footwear and accessories through more than 800 Journeys, Journeys Kids, Johnston & Murphy, Jarman and Underground Station stores. www.journeys.com and www.johnstonmurphy.com websites and its Johnston & Murphy and Dockers footwear businesses.

Key Manager Statement

"For our shareholders, this has meant the highest market value for Genesco stock in nearly 30 years. For the Genesco team, it means an exciting challenge this year: to sustain the vision and discipline that brought us this far, to keep our feet on the ground, our eyes on the future."

Ben T. Harris
Chairman & CEO

AirTran Holdings, Inc. • AAI • Transportation

Orlando, FL • IR Contact: Arne G. Haak • 407-251-3618

www.airtran.com

AirTran

	2000	1999*	Change
Total Revenues (millions)	\$624.1	\$503.8	24%
Net Income (millions)	\$47.4	\$29.1	63%
E.P.S.	\$0.69	\$0.45	53%

* 1999 figures exclude impairment charge and revenue gains from litigation

AirTran Holdings is the holding company for AirTran Airways, America's second largest low cost airline, which provides every day affordable airfares to customers in 34 cities throughout the Eastern United States.

Key Manager Statement

"AirTran Airways' record financial performance in 2000 was remarkable. What is most exciting is the growth we experienced this past year. So while our accomplishments in 2000 are in themselves tremendously exciting, they're only the beginning."

Joe Leonard, Chairman & Chief Executive Officer

EDO Corporation • EDO • Aerospace

New York, NY • IR Contact: William J. Frost • 212-716-2000

www.edocorp.com

EDO corporation

EDO Corp. supplies highly engineered products for government and industries worldwide, including advanced electronic, electromechanical and information systems and engineered materials critical to the mission success of its customers. EDO's Defense Segment provides integrated front-line war fighting systems, including radar countermeasure, aircraft weapons storage and release, airborne mine countermeasure, and sonar systems. EDO's Space & Communication Segment addresses the needs of the remote sensing, communication, navigation, and electronic warfare industries with ultra-miniature electronics and a broad line of antennas. EDO's Engineered Materials Segment supplies piezoelectric and advanced composites for multiple industries for civilian infrastructure and military applications.

Key Manager Statement

"Our merger with ALL Technologies, Inc. has gone very well. Our financial performance has met or exceeded expectations. Sales, backlog and earnings before merger related costs all increased significantly over prior year. All of these factors indicate the strength of our core businesses."

James M. Smith, Pres. & CEO

26-WEEK SMALL-CAP REVIEW COMPANY DIRECTORY

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OFFERING ADVICE TO ABBY



BY ROBERT BARKER
rb@businessweek.com

Why Fidelity's new president should tell investors more about the fund's trustees—who are the guardians of their money

Ms. Abigail P. Johnson
President
Fidelity Management & Research Co.
82 Devonshire St.
Boston, Mass. 02109

Dear Abby:

Letters that start out "Dear Abby" usually end up asking for advice. If you don't mind, I'd like to turn that around and give you some advice, just as soon as I offer my congratulations on your recent promotion. To lead the company that runs \$907 billion in Fidelity mutual funds is a giant opportunity to make tons of money, while brightening the futures of millions of investors.

As you take over, pay no mind to the mean spirits who, when you walk by, see nothing but nepotism. Sure, you have always had an edge. You're the top shareholder in a private company founded by your grandfather and still headed by your dad. But after 14 years as industry analyst, portfolio manager, and fund executive, you have invested plenty of yourself in Fidelity.

You announced the other day that everybody on your fund-management team shares "the same goal: to do the best job we can for our fund shareholders." But in at least one crucial way, Fidelity is letting shareholders down. In all of its educational efforts and marketing, Fidelity does little to explain the key legal fact of life for every investor in every mutual fund: When investors buy in, they become outright owners of the fund. The Fidelitys of the world exist to

service the fund, investing assets and doing kinds of grunt work, for fees. Overseeing you the independent trustees who by law must sit on every mutual fund's board to guard investors' interests. And every penny they agree to so Fidelity is one less penny for investors.

None of this is news to you, I know, and it's perfectly rational to want fund owners (and bosses) to keep lying like sleeping dogs. I was surprised to find out just how nearly invisible your independent trustees remain. Search yourself at www.fidelity.com. Search and you find no mention of them, beyond their names on the last page of the funds' annual reports.

NOT ALONE. There, investors can see a list of trustees, most with asterisks signifying their dependence from Fidelity. A new name on the list is Marie L. Knowles. Who is she? What is her experience? How can she be contacted?

Investors can get those answers only by knowing to ask for an obscure Securities & Exchange Commission filing called "Statement of Additional Information." It shows that Knowles is a retired chief financial officer of Atlantic Richfield. She also sits on three corporate boards, along with those of the Smithsonian and Brookings institutions. The address for her and other independent trustees is

P.O. Box 9235, Boston, Mass., 02205-9235.

You're right, Fidelity is hardly alone. No mention of independent trustees at the Funds site, and the barest description of their role at T. Rowe Price's. But Vanguard's materials spotlight the trustees' role, and one of your affiliates, Fidelity Charitable Fund, puts names, photos, and backgrounds of trustees on page one of its annual report.

Next year, the SEC will force funds to provide basic information on trustees in annual reports. That's why now is the moment to steal a march on your rivals. You lead one of the best companies. Certainly the biggest. So, do the thing. The open, strong, and confident thing that, as you've promised, aims at the best job for shareholders. Encourage independent trustees to take a high profile, light their watchdog role in your market, and new-account applications. Make your clients know who looks out for their reward? You will keep earning their trust.



JOHNSON: She can steal a march on her rivals

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www.ic.siemens.com

SNAP Appliances
www.snapappliances.com

Sprint
www.sprint.com

Sun Microsystems
www.sun.com

Symbol Technologies
www.symbol.com

Telecom Italia Spa
www.telecomitalia.it

The Hertz Corporation
www.hertz.com

The McGraw-Hill Companies
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The Timken Company
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LOEWS HITS THE HIGHS



GENE G. MARCIAL

is on a roll
d could be
way more.
er Parfums,
ance deals
blossoming.
media rivals
e angling for
ir Broadcast

After dismal results in 1998 and 1999, Loews (LTR) now appears to be in the right businesses at the right time. Its huge stakes in insurance, tobacco, and offshore oil-and-gas drilling have turned out to be godsend: They have sent Loews' sales and profits to levels exceeding expectations. "Once regarded by the Street as a private preserve of the Tisch family, Loews has emerged as a triple-crown value winner," says Robert Lyon, president of Institutional Capital, which holds 6 million shares, or 3.5%, of Loews. The Tisch family owns about 50%. CEO James Tisch, notes Lyon, has become more "communicative" about Loews' strategy.

The stock streaked from 44 in mid-January to 72 four months later, before easing to 68 on June 6. It trades at a price-earnings ratio of 10.5 on estimated 2001 earnings. Lyon argues that Loews deserves a higher multiple. The stock "very conservatively is worth 95," he says.

On a sum-of-the-parts valuation, Lyon estimates Loews' worth at 100 a share: Lyon values Loews' 87% stake in insurer CNA Financial at 30 a share in Loews stock. Loews also owns 53% of Diamond Offshore Drilling, valued at 15. And Loews' Lorillard Tobacco unit is valued at 45, based on a 10 multiple on estimated 2002 earnings of \$4.50 a share. With cash of \$10 a share, total value adds up to 100. This doesn't include holdings in Bulova and Loews Hotels. Lyon sees Loews earning \$8.33 a share in 2002, up from an estimated \$6.43 in 2001.

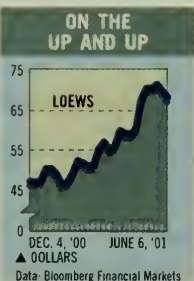
Marc Cohen of Goldman Sachs, who is also high on Loews, says Lorillard has been posting solid income growth, and CNA continues to improve margins.

INTER PARFUMS IS SMELLING LIKE A ROSE

When this column featured Inter Parfums (IPAR) on Jul. 10, 2000, the stock was trading at 7. That was a few months after LVMH Moët Hennessy Louis Vuitton, the world's largest luxury-goods maker, had acquired some 20% of Inter Parfums, a New York maker and distributor of brand-name fragrances, including Burberry, Christian Lacroix, and S.T. Dupont. The stock closed at 12 on Jun. 6. Inter Parfums has blossomed: Sales broke through \$100 million in 2000 and are expected to hit \$116 million in 2001 and \$127 million in 2002, up from 1999's \$87 million. Earn-

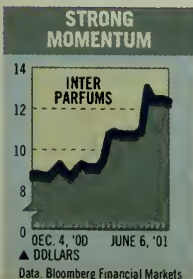
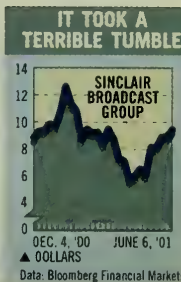
ings in 2001 are seen rising to 60¢ and 68¢ in 2002, vs. 51¢ in 2000 and 40¢ in 1999.

With such momentum—Inter Parfums' first-quarter sales jumped 40%, and earnings rose to 16¢ a share, up from 11¢ a year ago—some think LVMH may now raise its stake to 25%, prior to possibly making a bid for a majority stake. "LVMH and Inter Parfums now have a close working relationship in licensing and introducing new fragrances," says Howard Halpern, an analyst at Taglich Brothers, a New York investment firm. He says Inter Parfums' product pipeline and launch schedule are strong for 2001 and 2002. LVMH usually winds up buying the companies in which it has taken a big stake. Halpern doesn't know that LVMH will make a move, "but the possibility exists," he adds. A corporate insider says that with the company on the way to hitting its long-term goals, CEO Jean Madar isn't looking to sell. "But a 25-a-share offer might be too tempting," he says, adding that the company needs a rich partner to grow and compete.



SINCLAIR BROADCAST OFFERS IN THE AIR?

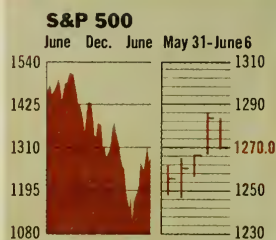
Is Sinclair Broadcast Group (SBGI) on the block? It may be, if the Smith family wants to do a deal. Headed by CEO David Smith, the Smiths control 91% of the Class B voting stock. Some large institutions own Class A stock, including Neuberger Berman, with 15%, and Citigroup, with 10%. The stock has tumbled—from 13.75 on Jul. 11, 2000, to 9 on Jun. 6, 2001—because of weak ad sales. The stock trades "at the lowest multiple in the TV group," notes Andrew Marcus of Deutsche Bank Alex. Brown. Yet he rates the stock a buy—because it is trading at only half Sinclair's estimated asset value of 16 to 20 a share. Sinclair owns 62 TV stations in 40 mid-markets, including major network affiliates. Fox affiliates account for 34% of broadcast revenues, and WB affiliates, 32%. Whispers are that a couple of media biggies have talked to Sinclair about a buyout. Its undervalued assets, plus some pending regulatory changes, make Sinclair a likely target, say these pros. Scott Davis of First Union Securities says that anticipated rule changes, such as lifting the national-ownership cap and the restriction on cross-ownership with newspapers, would make it possible for Fox or Tribune to buy Sinclair. CEO Smith wasn't available for comment.



BusinessWeek online

Read Gene Marcial's Inside Wall Street Online column Tuesday afternoons at www.businessweek.com/today.htm. And see him Fridays at 1:20 p.m. EST on CNNfn's *The Money Gang*.

Stocks



COMMENTARY

This week's tech stock volatility was the good kind. The issues fired a 6.4% rebound in the Nasdaq, nearly making up the loss of the prior week. The reason: optimism that the mix of encouraging and discouraging earnings news is turning positive. Chipmaker Xilinx said order cancellations have slowed. Other semiconductors rallied. The Dow and S&P were comparatively boring.

Data: Bloomberg Financial Markets
Bridge Information Systems, Inc.

U.S. MARKETS

	June 6	Week	Year to date	Last 12 months
S&P 500	1270.0	1.8	-3.8	-12.9
Dow Jones Industrials	11,070.2	1.8	2.6	3.1
Nasdaq Composite	2217.7	6.4	-10.2	-41.0
S&P MidCap 400	534.0	3.7	3.3	8.1
S&P SmallCap 600	230.9	3.2	5.2	10.9
Wilshire 5000	11,787.8	2.3	-3.2	-13.2

SECTORS

	June 6	Week	Year to date	Last 12 months
BusinessWeek 50*	882.2	2.0	-9.1	-27.8
BusinessWeek Info Tech 100**	496.7	5.0	-12.2	-47
S&P/BARRA Growth	631.8	2.5	-8.1	-27.2
S&P/BARRA Value	638.1	1.1	0.3	3.6
S&P Energy	952.2	-0.4	2.2	5.7
S&P Financials	160.0	0.9	-2.9	11.7
S&P REIT	91.0	1.7	3.4	14.4
S&P Transportation	734.6	0.6	5.3	26.0
S&P Utilities	314.6	-3.4	-10.3	17.3
GSTI Internet	140.7	4.3	-22.6	-70.3
PSE Technology	777.5	6.1	-4.5	-28.1

*Mar. 19, 1999=1000

**Feb. 7, 2000=1000

BEST-PERFORMING GROUPS

	Last month %	Last 12 months %
Pollution Control	16.3	Engineering & Constr. 117.3
Toys	15.2	Tobacco 92.7
Metal & Glass Containers	13.9	Hospital Management 62.0
Health-Care Services	13.4	Homebuilding 61.8
Specialty Printing	11.8	Savings & Loans 60.5

GLOBAL MARKETS

	June 6	Week
S&P Euro Plus (U.S. Dollar)	1199.9	0.0
London (FT-SE 100)	5901.5	1.8
Paris (CAC 40)	5496.5	-0.8
Frankfurt (DAX)	6192.4	2.5
Tokyo (NIKKEI 225)	13,174.8	-2.4
Hong Kong (Hang Seng)	13,576.0	1.2
Toronto (TSE 300)	8194.4	1.1
Mexico City (IPC)	6791.0	3.1

FUNDAMENTALS

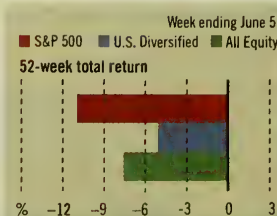
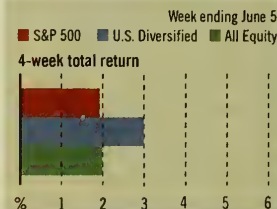
	June 5	Week
S&P 500 Dividend Yield	1.22%	1.22%
S&P 500 P/E Ratio (Trailing 12 mos.)	29.3	29.3
S&P 500 P/E Ratio (Next 12 mos.)*	22.1	22.1
First Call Earnings Revision*	-2.59%	-1.6%

*First Call Corp.

TECHNICAL INDICATORS

	June 5	Week
S&P 500 200-day average	1325.0	1335.0
Stocks above 200-day average	74.0%	70.0%
Options: Put/call ratio	0.65	0.5
Insiders: Vickers Sell/buy ratio	2.57	2.0

Mutual Funds



Data: Standard & Poor's

EQUITY FUND CATEGORIES

4-week total return	%	52-week total return	%
Leaders		Leaders	
Health	10.5	Financial	26.0
Precious Metals	6.8	Small-cap Value	24.9
Latin America	5.7	Mid-cap Value	22.3
Small-cap Value	5.4	Natural Resources	21.4
Laggards		Laggards	
Japan	-6.0	Technology	-45.6
Communications	-3.6	Communications	-44.2
Diversified Pacific/Asia	-3.4	Japan	-32.9
Foreign	-1.9	Diversified Pacific/Asia	-28.1

EQUITY FUNDS

4-week total return	%	52-week total return	%
Leaders		Leaders	
World GenomicsFund com	20.0	Schroder Ultra	101.3
Munder Bio Tech2 B	18.7	Potomac Internet Short	80.0
iShares NASDAQ Biotech.	17.8	Bost. Part. Sm. Cap Val. II	72.9
Rydex BioTechnology Inv	16.2	CGM Focus	72.5
Laggards		Laggards	
Millennium Gr. & Income	-13.1	Jacob Internet	-75.9
Cr. Suisse Warb.P. Jap. Gr.	-12.7	Potomac Internet Plus	-71.7
Millennium Growth	-11.9	Firsthand E Commerce	-70.2
Cr. Suisse W.P. Jap. Sm. Co.	-11.0	Firsthand Communications	-70.2

Interest Rates

KEY RATES

	June 6	Week
MONEY MARKET FUNDS	4.18%	4.2
90-DAY TREASURY BILLS	3.61	3.6
1-YEAR TREASURY BILLS	3.56	3.7
10-YEAR TREASURY NOTES	5.25	5.5
30-YEAR TREASURY BONDS	5.65	5.8
30-YEAR FIXED MORTGAGE†	7.18	7.3

†BancQuote, Inc.

BLOOMBERG MUNI YIELD EQUIVALENT

Taxable equivalent yields on AAA-rated, tax-exempt bonds, assuming a 31% federal tax rate.

	10-yr. bond
GENERAL OBLIGATIONS	4.38%
TAXABLE EQUIVALENT	6.35
INSURED REVENUE BONDS	4.52
TAXABLE EQUIVALENT	6.55

THE WEEK AHEAD

RETAIL SALES Wednesday, June 13, 8:30 a.m. EDT ► Retail sales likely grew 0.3% in May, after jumping 0.8% in April. That's according to the median forecast of economists surveyed by Standard & Poor's MMS, a unit of The McGraw-Hill Companies. Excluding vehicles, May sales probably advanced 0.4%.

EXPORT-IMPORT PRICES Wednesday, June 13, 8:30 a.m. EDT ► Export prices in May are expected to remain unchanged, while import prices are expected to rise 0.2%.

BEIGE BOOK Wednesday, June 13, 2 p.m. EDT ► The Federal Reserve Bank will release its compilation of regional economic activity in advance of the policy meeting scheduled for June 26-27.

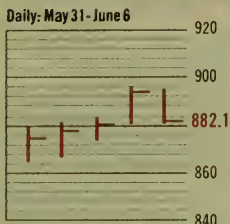
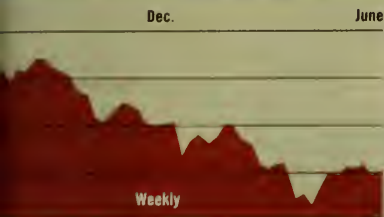
BUSINESS INVENTORIES Thursday, June 14, 8:30 a.m. EDT ► Inventories in April likely remained unchanged.

PRODUCER PRICE INDEX Thursday, June 14, 8:30 a.m. EDT ► Producer prices of finished goods probably rose 0.2% in May.

Core prices, which exclude food and energy, are expected to inch up.

CONSUMER PRICE INDEX Friday, June 15, 8:30 a.m. EDT ► Consumer prices for goods and services likely increased 0.4%. Excluding food and energy, prices likely grew by a smaller 0.2%.

INDUSTRIAL PRODUCTION Friday, June 15, 9:15 a.m. EDT ► Factory output fell 0.3% in May. The average rate likely fell to 78.1%, from



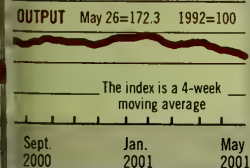
a good week, up 2.0%—thanks to Oracle. The software giant climbed nicely every day, racking in for the week. It was a case of no news is good news, as analysts were encouraged when the issue an earnings warning for its quarter ended May 31. Other tech issues were up on hope that Energy stocks Calpine, El Paso, and AES were caught in the California power struggle.

COMPANY PERFORMANCE

Company	% change		Rank	Company	% change	
	Week	Since 3/1/01			Week	Since 3/1/01
National	0.6	3.7	26	Verizon Communications	0.8	12.4
Petroleum	-2.7	-4.6	27	Alza	6.4	30.8
	-8.4	-1.8	28	Citigroup	2.1	6.6
	-1.3	2.3	29	Sun Microsystems	8.4	-12.2
Materials	7.6	16.2	30	Merck	0.9	-7.3
Financial	-0.8	14.8	31	El Paso	-3.9	-19.0
Petroleum	-0.3	24.9	32	Altera	12.9	3.5
	-3.0	-3.3	33	Marsh & McLennan	-2.1	-0.1
	1.3	7.5	34	Household International	0.2	12.9
Others Holdings	17.2	-20.5	35	Chevron	0.3	10.7
	-0.4	5.0	36	SBC Communications	-1.1	-8.1
	9.2	-21.2	37	Mercury Interactive	10.9	11.7
	-4.7	-22.3	38	AOL Time Warner	2.3	18.8
Utilities	1.0	11.3	39	Washington Mutual	1.2	6.6
Financial	0.1	2.3	40	General Dynamics	-1.4	16.4
Technology	12.9	15.5	41	Comcast	-2.7	-6.6
	9.7	9.0	42	Morgan Stanley Dean Witter	0.5	1.4
Mass	-0.3	16.8	43	Tellabs	-6.8	-26.9
Y	-6.9	0.0	44	Exxon Mobil	0.6	9.8
Communications	14.0	-24.9	45	Scientific-Atlanta	3.6	15.5
Financial	0.9	18.7	46	U.S. Bancorp	4.5	-0.6
Petroleum	-2.4	18.3	47	Paychex	-1.6	-1.6
Ces	11.9	18.1	48	Merrill Lynch	2.0	9.2
Ces	-7.2	-4.3	49	Bed Bath & Beyond	2.3	21.1
Health	0.3	7.9	50	Texas Instruments	7.3	9.6

Production Index

Change from last week: -0.6%
Change from last year: 2.0%



index fell for the eighth consecutive week. Before calculation of the fourage, the index slipped from 171.3 to onal adjustments, declines in steel production led the index lower. Autos / unchanged, as producers prepare vn in production. Among the compo-oil refining led the way, followed ucks, and rail-freight traffic.

* the index components is at www.business-week.com Copyright 2000 by The McGraw-Hill

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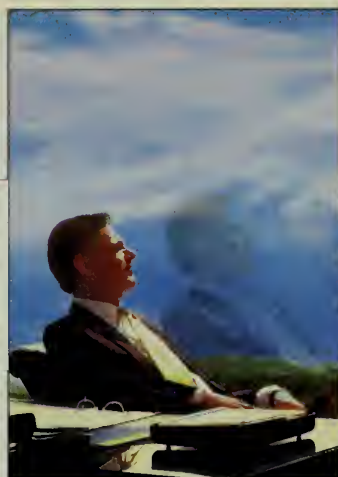
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BusinessWeek (ISSN 0007-7135) published weekly, except for one week in January August, by The McGraw-Hill Companies, Inc. Executive, Editorial, Circulation, and Advertising departments are located at 1221 Avenue of the Americas, New York, N.Y. 10020. U.S. subscriber rate \$54.95/year, \$69/year. Periodicals postage paid at New York, N.Y., and at additional mailing offices. At Montreal, P.Q. Canada Post International Publications Mail Product Sales Agreement Postmaster: Send address changes to BusinessWeek P.O. Box 430, Hightstown, N.J. 08520.

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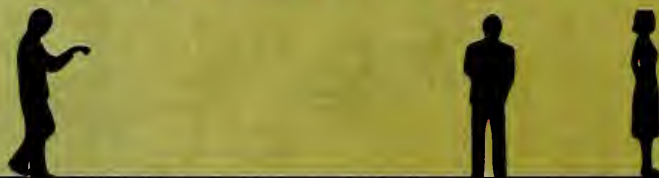
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THE MICROSOFT DILEMMA

Whether you love Microsoft Corp. or hate it, you can't help being in awe of the world's most relentless company. Just last year, in *U.S. v. Microsoft*, Federal District Judge Thomas Penfield Jackson ordered the company split in two. The stock fell nearly 60% from peak to valley, and talent fled. Yet Chairman William H. Gates III and CEO Steven A. Ballmer never lost faith that Microsoft would prevail.

Today, their company is scoring big wins with new products, as detailed in a recent *BusinessWeek* Cover Story ("Microsoft," June 4). Its stock has recouped a third of its losses, and it has \$30 billion in cash. Meanwhile, the threat of breakup is diminishing. A federal appeals court will rule soon on Microsoft's appeal of Jackson's decision. Many experts expect the appellate judges to reject parts of Jackson's rulings. That could set off new settlement talks. And Microsoft would likely get a better deal from Justice now that antitrust skeptic George W. Bush has replaced Bill Clinton in the White House.

Should the world fear an unshackled Microsoft? It's an intriguing question. Microsoft has ceased the most egregious tactics cited in the antitrust case—cutting exclusive deals with computer makers to shut out rivals. And it's hard to see how Microsoft is harming consumers with its latest bundling initiatives. Take Windows XP, the desktop operating system that's slated for release on Oct. 25. It will make life easier for customers by seamlessly integrating a range of Microsoft products and services. Microsoft's Passport service lets customers create a digital wallet so they can shop at Web sites

without divulging their credit-card numbers to each other. .Net services, which will begin to appear next year, will let unrelated Web sites communicate with each other and run programs so customers can instruct the Internet to do complex jobs—such as sending e-mail alerts if a flight is late or stock is falling. Each extension of Microsoft's sphere of influence makes computers a bit simpler to use.

The drawbacks of Microsoft's dominance are less obvious. Still, they're real. For one, innovation may well be delayed. Venture capitalists generally won't fund companies that might have to attack Microsoft head-on. Even many established companies hesitate to try something that Microsoft might slap. Unfortunately, innovation gets short shrift in the antitrust debate, because it's intangible. When an idea dies in its crib, loss is hard to measure.

Another danger posed by Microsoft is yet harder to quantify. It's the danger to American society if a single company gains a chokehold on information technology, the key to growth in the New Economy. Microsoft's power rivals that of the 19th century trusts, whose dominance sparked the populist movement and drove Congress to pass the Sherman Antitrust Act of 1890.

We're left with a dilemma. Break up or restrain Microsoft and you lose clear, immediate consumer benefits. Settle and you risk long-run harm to innovation and the emergence of a company that is simply too powerful. After all the time and expense that have gone into *U.S. v. Microsoft*, the important issues underlying the case remain unresolved.

U.S. FOREIGN POLICY: LET'S TALK

On the eve of President Bush's first trip to Europe to meet with key NATO allies and talk with Russian President Vladimir V. Putin, U.S. foreign policy is lurching in an unknown direction. The Bush Administration's desire to reshape foreign policy for the 21st century is laudable (page 62). The impulse to integrate Russia into a new security system is commendable. But the Administration's decision to craft this dramatically new foreign policy in secrecy, with little input from senior military officers or members of Congress, threatens to undermine the effort. It is time to end the secrecy and open a national discussion. Neither Presidential candidate campaigned on a radical change in U.S. foreign policy. The American people were not consulted then. They should be now. With Democrats taking over Senate committees on defense and foreign policy, a bipartisan debate in Washington would be a welcome first step.

There are disconcerting leaks out of the Pentagon about Bush's policy. There's talk of shifting the defense focus away from Europe toward Asia; targeting China as the long-term enemy; redirecting submarines, missiles, and other military re-

sources to the Pacific; and building a new generation of long-range, trans-Pacific bombers and missiles. What the Pentagon appears to be suggesting militarizing outer space. This should be aired before policy is changed, not after.

The risk is that the Administration's fears will become self-fulfilling prophecies. Defining China as a foe and it as such will surely make it behave as one. While its tyranny, dictatorship and repression of human rights are undeniable, China hasn't threatened the U.S. in the way that the Soviet Union did. It isn't spreading communist ideology around the world. In fact, China embraces capitalism and is integrating its economy with the U.S. and Taiwan.

The success of U.S. cold war policy was based on secrecy. After Soviet tanks rolled into Eastern Europe, a national discussion occurred. Political parties, business, labor, and other segments of American society openly talked about the direction foreign policy should take. Today, the international situation is less clear and open to more outcomes. It needs a new consensus to go forward. Foreign policy should not be made in secrecy.

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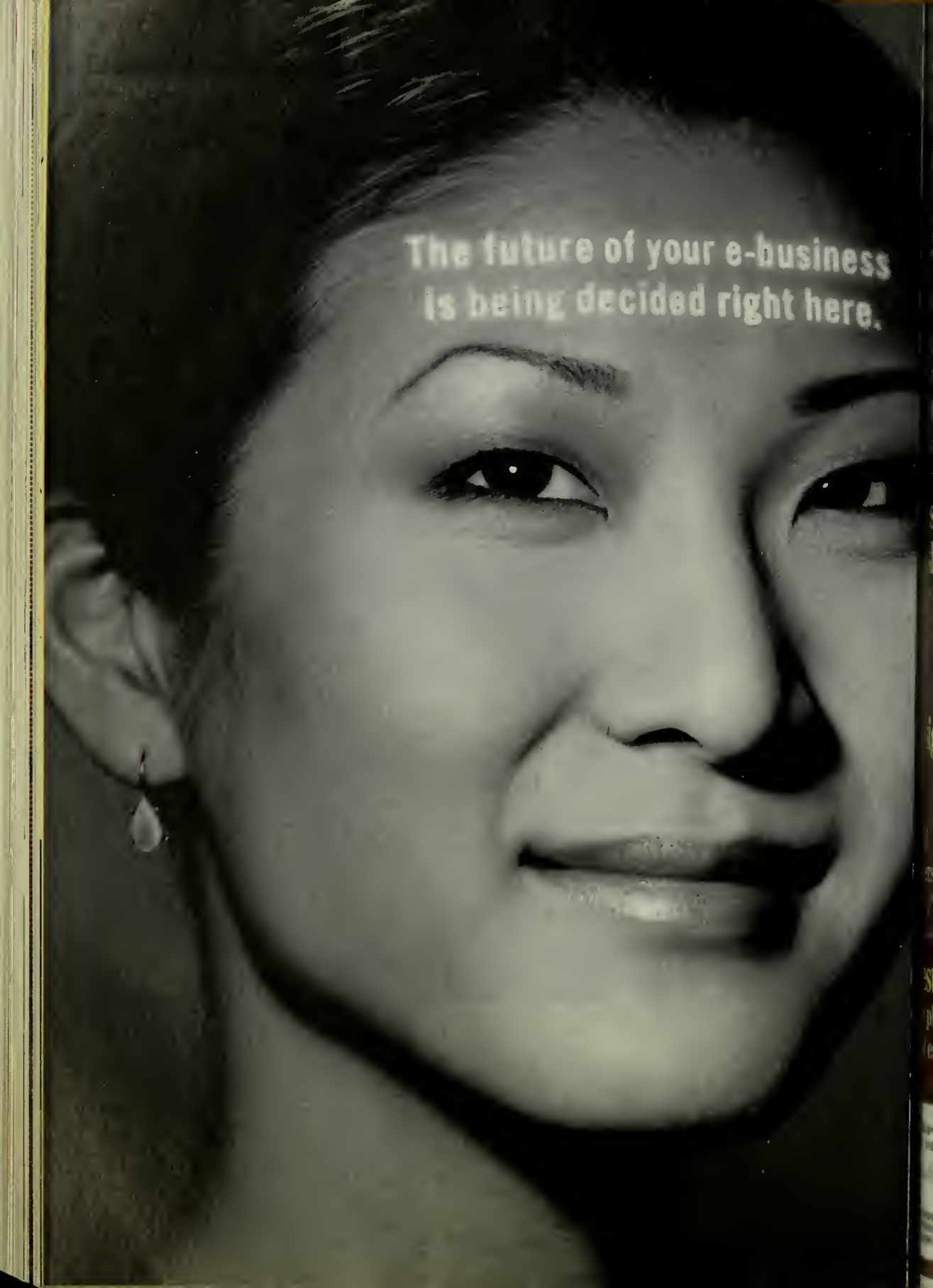
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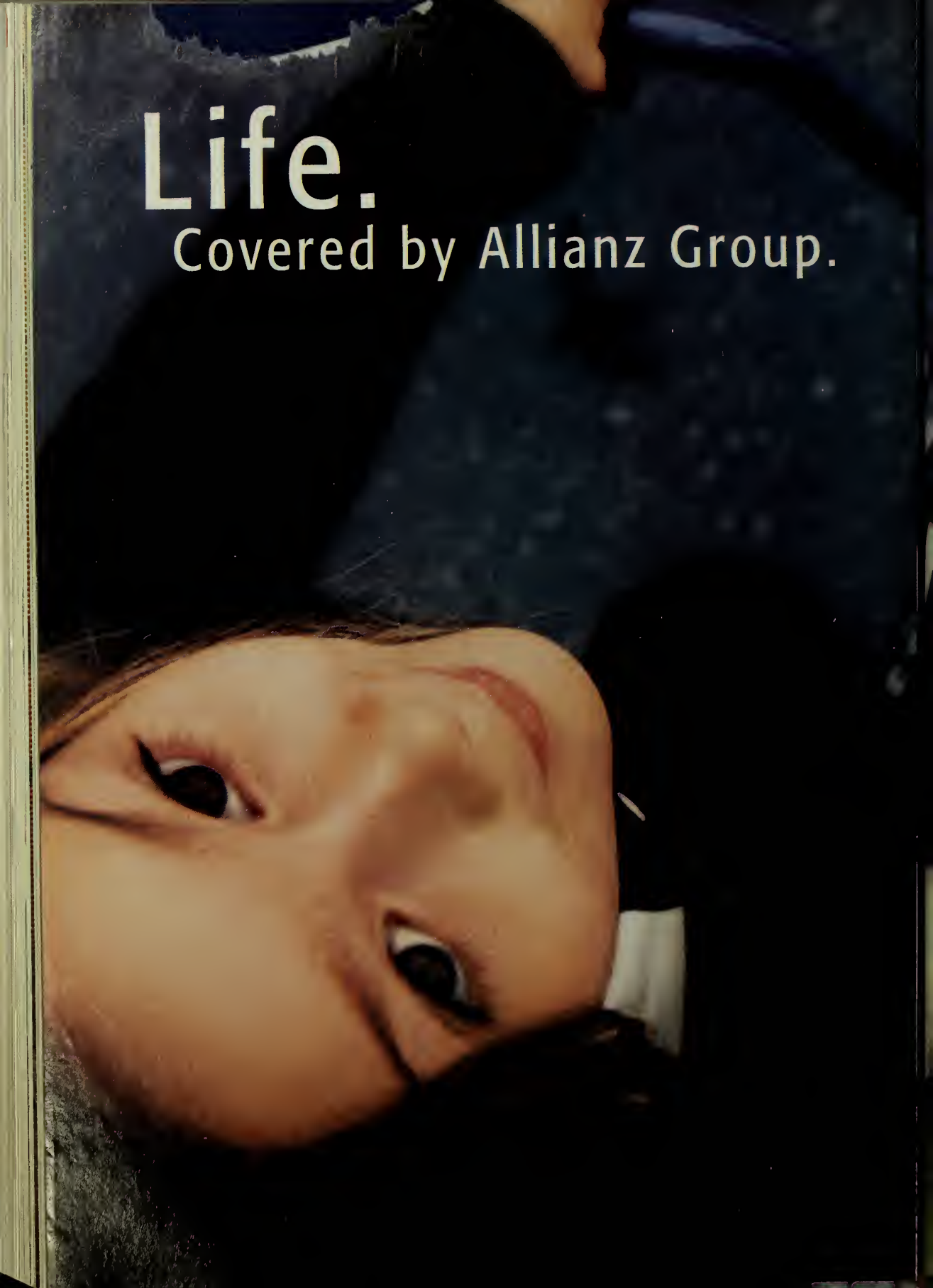
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STARTING OVER

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A few years ago, it looked as though Ford was on its way to becoming the world's No. 1 carmaker. As recently as this year, analysts were recommending Ford shares as the Big Three stock to own. Since then, Chief Executive Jacques Nasser's ambitious plan to shift the company into overdrive has plowed, head-on, into some stubborn realities, including a crisis in vehicle quality and plummeting employee morale. Can boss Nasser get his company back in gear?

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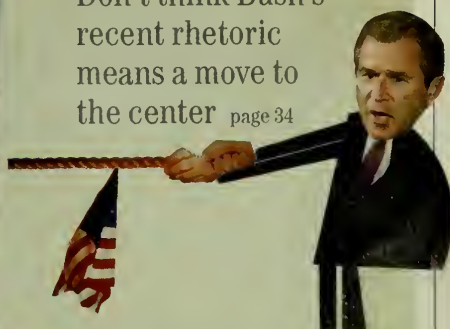
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Companies should stop wielding scary but unproven cost estimates and help design a law that will protect consumers



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Up Front

EDITED BY
SHERIDAN PRASSO

of Manufacturers says that could help the U.S. rebound faster. "American business is not firing as many of its own customers," he reasons.

Among the giants going abroad with their axes: Motorola, Good-year, Procter & Gamble, Compaq Computer, JDS Uniphase, and Delphi Automotive. Each is cutting at least 2,500 overseas jobs. Sara Lee recently announced 1,300 job cuts—not one in the U.S. All are at its Hanes clothing plants in Central and South America. Those were on top of 7,000 layoffs earlier this year that were almost entirely in Europe. Why the foreign bias? After restructuring its U.S. operations in the 1990s, Sara Lee says overseas is where it can now save the most money.

Of course, many Americans are still getting tossed out of work. But it's clear the rest of the world is sharing their pain.

Michael Arndt

DOWNTURN BLUES

ONE EXPORT THAT'S HOT: LAYOFFS

FOR YEARS, AMERICAN multinationals have been pilloried for shipping U.S. jobs overseas. Now, they're exporting something else: layoffs. As more and more employers respond to the economic slowdown by hacking payrolls, a growing number are giving their job-chopping abroad.

The toll is substantial. Dig into the 10 biggest cutbacks announced by U.S. companies this year, and you'll find that at least 46,000—almost half the jobs axed—are abroad. Economist Gordon Richards of the National Association

TALK SHOW "Microsoft is going to suck the value out of the telecommunications companies."

—Former Bell Labs researcher David Isenberg to The New York Times on Microsoft's plans to turn computers into telephones

CULTURE SHOCK

GE EMBRACES THE PAPERLESS OFFICE

ONE OF CORPORATE AMERICA'S toughest cost-cutters, General Electric, has declared war on employee desktop printers. The same goes for individual fax machines and copiers—or any other machine that spits out paper and isn't shared by a group of workers.

GE is removing such equipment by the truckload—handing them back to vendors, giving them to charities, or, as a last resort, dumping them in the trash. The haul: 30,000 ma-

chines when it's all done next year. Paper consumption is already down 28% since Gary Reiner, the head of GE's Net strategy, issued the edict six months ago. GE expects to save \$18 million a year.

Dumping printers and faxes is part of Reiner's plot to persuade the 300,000-

workers at GE to live with the breathe Net culture.

"Big cultural shift," he says, "will take time."

"We're just at the beginning of this one," says So far, loud complaints from the deprived. They say they're happy to store data in laptops and smart phones, but company-provided, of course.

Pamela L. M.

THE ENERGY CRUNCH

SURCHARGES, HOME-DELIVERED

EVERYONE KNOWS THERE'S NO such thing as a free lunch. Now, in a growing number of cities, there's no such thing as free pizza delivery, either. Hoping to offset higher fuel costs, franchisees at the nation's biggest pizza chains, including Pizza Hut, Domino's, and Papa John's, are starting to charge fees of \$1 or more on each delivery. Like many trends, the surcharges began in Southern California, but they've spread to the Midwest, where gas prices have topped \$2 a gallon.

The pizza surcharge is just the latest fee being passed on to consumers for high fuel costs. Airlines have been imposing fuel surcharges since early 2000, when energy prices first surged. Then shippers such as United Parcel Service and FedEx joined in. Today, even

hotels are slapping on charges, billing guests as much as \$3.50 per night to cover energy costs.

At least one pizza chain, Domino's—would like to keep deliveries free and has asked franchisees to stop charging consumers. But the franchisees can set their own policies. "Our costs are going up," says Alex Sarantopoulos, who owns 30 Papa John's in suburban

Los Angeles.

Pizza Hut is the other half of the fine with it. "A spokeswoman says there's nothing for convenience, having a meal delivered to home."

Michael A.

THE LIST BIG TOBACCO'S BIG PAYOUTS

The \$3 billion award to a lung-cancer victim by a Los Angeles jury on June 6 pushed punitive damages to unprecedented levels. Since the first key case, in 1988, awards* to smokers have been skyrocketing. With dozens more suits nationwide, how far will juries go?

Here are some key verdicts:

June, 2001 PHILIP MORRIS \$3 BILLION	March, 2000 PHILIP MORRIS/ R.J. REYNOLDS \$21.7 MILLION	March, 1999 PHILIP MORRIS \$80.3 MILLION	February, 1999 PHILIP MORRIS \$51.5 MILLION
June, 1998 BROWN & WILLIAMSON \$952,000	August, 1996 BROWN & WILLIAMSON \$750,000	June, 1988 LIGGETT \$400,000	*Initial jury awards; many are reduced or overturned on appeal. Data: Salomon Smith Barney Tobacco Research

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Up Front



CHRISTENSEN:
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TRY AGAIN

DON'T JUDGE A FUND BY THE BOOK

MANAGEMENT GURU AND Harvard Business School professor Clayton Christensen was once called a rising star of the New Economy and "the most important business thinker in the world today." His celebrated 1997 book, *The Innovator's Dilemma*, remains a best-seller. So when he launched a

mutual fund last year, the financial world had high expectations.

As it turned out, the Nasdaq peaked on the fund's first day, Mar. 10, 2000. And, *BusinessWeek* has discovered through SEC filings, the fund quietly closed before seeing its first birthday. The \$3.8 million Disruptive Growth Fund, which Christensen co-managed with St. Louis brokerage owner Neil Eisner, held 45 stocks, with Broadcom, Digex, and EMC among the largest holdings.

When the fund liquidated in February, it had lost 64% of its value. Christensen and Eisner declined to comment.

Nearly all the stocks were chosen by Christensen based on his theory that companies that develop innovative products—"disruptive technologies"—can topple market leaders. In hindsight, however, the only disruption was in sky-high valuations for tech stocks. *Susan Scherreik*

I-WAY PATROL

EAST BEATS WEST EXPLORING THE NET

FOR YEARS, ASIA LAGGED behind as the Net transformed the West. Today, though, Asians lead the world in page views, click rates on ad banners, and stickiness on Web sites, according to a survey by AC Nielsen eRating.com. The reason? A love affair with gadgets and tech, figures Hugh Bloch, an AC Nielsen managing director.

No Asian country is more Net crazy than South Korea. With few English speakers, "they've been forced by language to localize their Web sites," says Song Kwan Ho, president of the Korea Network Information Center, which doles out Korean domains. Now, Korean-language pages tailored to local tastes—

community sites, games, chat rooms, even info on university entrance exams—are drawing Netizens in droves. Koreans are the world's most active home surfers—hitting an average of 2,164 Web pages



SEOUL SURFERS: *Café society*

a month. That's nearly double the 1,123 page views in Hong Kong—which was second among 21 countries surveyed—and more than triple the 678 in the U.S. Koreans also lead in some e-commerce areas: More than 60% of all stock trades, even by pros, are done online. Hear that, E*Trade? *Moon Ihwan*

DRAWN & QUARTERED



SPORTS BIZ

COLLEGE MARKETERS PULL A FAST ONE

U.S. UNIVERSITIES, HAWKING everything from branded apparel to credit cards, haven't been shy about marketing their images like, well, a box of Tide.

But now, some are finding a new venue: NASCAR. In a novel promotion, 14 mostly public universities—including North Carolina, Michigan, Connecticut, and Purdue—are co-sponsoring a car driven by Elton Sawyer in the second-tier Busch Series. Each school gets to paint a car its colors once a year. (Sawyer drove a "Carolina Blue" in May.)

If seeing their alma mater linked with NASCAR rankles some alumni, university officials offer no apologies. "NASCAR reaches the masses probably better than any oth-



TAR HEELS:

new venue

er sport America," notes Norv Teague, associate athletic rector at North Carolina, whose goal is to promote Tar Heels. Adds Kyle M of the University of Kentucky, which aims to co-sponsor NASCAR's top-tier Winston Cup next year: "We think a lot the same fans fit with NASCAR and Kentucky."

There's huge potential. Imagine Auburn vs. Alabama on the track. *Brian C*

THE BIG PICTURE

LOTS O' ROOM AT THE INN

Business travel is way down this year as employers nationwide constrict their budgets. Hoteliers in these locales are taking a hit.



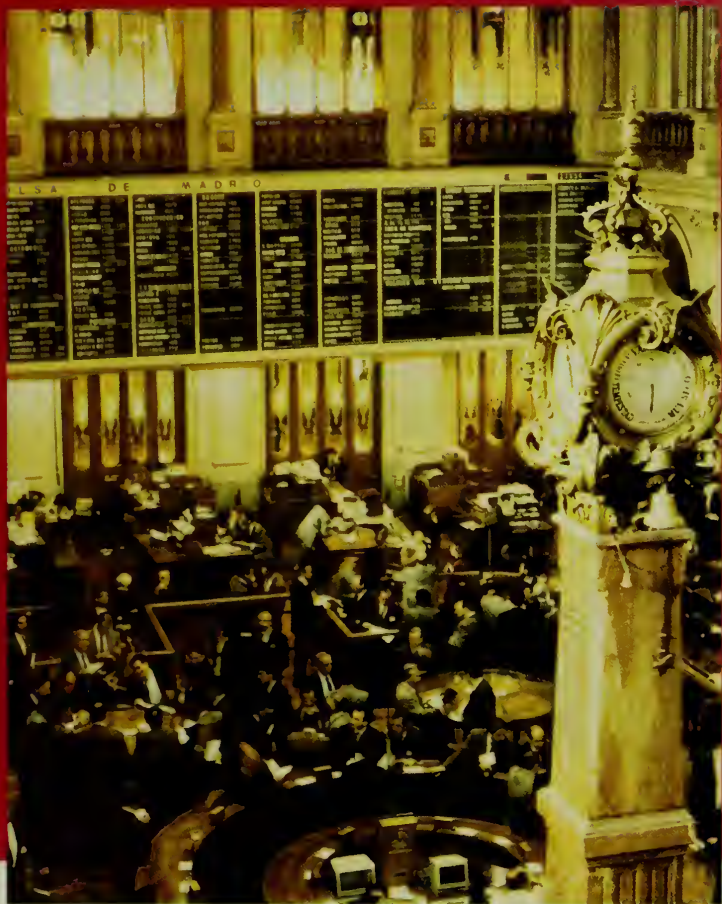
PERCENT CHANGE APRIL 2000-APRIL 2001

	OCCUPANCY RATE	REVENUE AVAILABLE
San Francisco/Silicon Valley	-17.4	-12
New York	-11.8	-8
Chicago	-10.1	-9
Boston	-7.1	+2

Data: Smith Travel Research, Economy.com

FOOTNOTES Women who report not getting credit for the same good idea as a man: **65%**; who say men excel at self-promo: **6**

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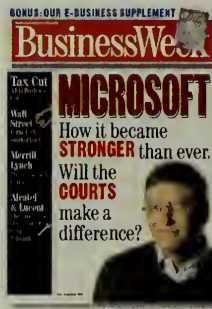
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KEEPING AN EYE ON MICROSOFT'S AMBITIONS

Manufacturers of computer hardware and software have borne the brunt of Microsoft Corp.'s sometimes predatory practices. The end user has been affected only indirectly ("Microsoft: How it became stronger than ever," Cover Story, June 4). Microsoft now appears eager to get into the software rental business. Any company that agrees to place the captive control of its crown jewel corporate accounting data under Microsoft's rental-price arrangements is as dumb as a box of rocks. It will quickly come to long for the good old days when the only companies accused of price-gouging a captive audience were the cable-TV companies.

John Graybill
Boca Raton, Fla.



Microsoft's Passport is seen as a repository of all our credit-card numbers, log-on IDs, and passwords, while Hailstorm is seen as a database of all of our contact lists, calendars, electronic mail, and a lot of other things.

The hackers and crackers of the world will see this as the ultimate target. Law-enforcement agencies will demand access. And if we all come to rely on it, Microsoft will eventually want to charge us a lot for its use.

Charles J. Wertz
Buffalo

It seems appropriate that Microsoft calls its software Passport—since issuing passports is the exclusive province of sovereign governments. And while Congress frets about Internet taxes, Microsoft moves aggressively ahead talking

"about collecting fees for every e-commerce transaction"—another province of sovereign governments.

Alan MacDonald
Sanford, Me

CITI: DON'T FORGET THE LITTLE GUY

Sandy Weill might want to investigate how his customers really feel about the service Citigroup provides if they are not big business customers in the U.S. ("Sandy Weill wants the world," Finance, June 4).

The individual customer who does banking here has had quite a hard time getting out the ever-changing policies. Let's get our home markets up to par, please.

Jerry C. Getma
Monterey Park, Calif.

LEAVING LOW-SKILLED WORKERS OUT IN THE COLD

One problem with mandating higher wages is that employers then tend to hire workers with more skills ("What exactly is a living wage?" Social Issue, May 28). This forces those with marginal skills into poverty because they cannot compete. Even living-wage activists agree. David Reynolds, who wrote the handbook on how to organize a living-wage movement, said that employers "should attract and retain the best workers" following the implementation of living-wage mandates. The laws, he said, "will likely result in higher caliber of worker." What is to become of the low-skilled employee who have lost their jobs? A better alternative is a state or local Earned Income Tax Credit. Such credits reward

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A Division of The McGraw-Hill Companies

JUNE 25, 2001 (ISSN 0007-7135) *** 3738

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Or will you be blown away?

(PERPETUAL THINKING PROCESS)

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Readers Report

CORRECTIONS & CLARIFICATIONS

tion on SFX and superagent David Falk parks fly at SFX," Sports Business, June 2001. I erroneously said that Falk represents A star Allen Iverson. Falk is no longer Iverson's agent.

target benefits to families in need, do not discourage employers from hiring low-skilled workers.

Thomas K. Dilworth
Employment Policies Institute
Washington

BE SURE THE ETHANOL NUMBERS ADD UP

Fuel standards: How to plug the gaps" (News: Analysis & Commentary, June 28) stated that flexible-fuel vehicles get 30 to 40 mpg on ethanol and 20 mpg on gasoline. This is absurd. Because ethanol is already partially oxygenated, the energy derived from combustion is only about 65% of that of a hydrocarbon per unit weight. But since ethanol is 12% denser, the figure rises to 78%. Thus we would expect the mpg on ethanol to be 25% less than that of gasoline, not 50% to 100% greater.

J. Thomas Denison
Orange, Tex.

Editor's note: The story should have stated that, in figuring corporate average fuel economy (CAFE), makers of flexible-fuel vehicles may claim credit for 30 mpg, even though actual mileage is roughly 25% less.

FASB RESCUE HIGH-TECH ACCOUNTING FROM CHAOS

For years, investors relied on the Financial Accounting Standards Board (FASB) to set generally accepted accounting principles (GAAP). Then came the Net, and dot-coms rushed in with analytical ("The numbers game," Cover Story, June 14). But no one stepped forward to fill the gap in generally accepted accounting techniques (GAAT).

The Securities & Exchange Commission must recognize the importance of GAAT, address the convergence of accounting with analytics, and maybe even create a GAAT-maker. My vote would be for the U.S. has the best accounting standards in the world. It's time for a new series for the Information Age.

Rosemary Schlank
Rye Brook, N.Y.

any stakeholders are concerned with

the future, not the past as reflected in GAAP financial statements. Pro forma (Latin for "as if") statements report the impact of a planned transaction as if it had occurred, and this information is useful. Stakeholders must be aware that the location of "real earnings" is in the financial statements that are attested for by an independent auditor, not in the ones presented by management that may show a possible future.

Todd Transue
Riverside, Calif.

DOT-COM SURVIVORS MAKE SILICON VALLEY STRONGER

I have lived in Santa Clara, Calif., my whole life. The natives here have seen the likes of dot-commers come and go before ("California, here I go," Working Life, May 28). They won't all disappear: The smart, tough ones will stay. Sorry, but the real talent is knowing how to deal with the good times and the bad. Those who have it have made this valley strong.

Thomas Zizzo
San Jose, Calif.

So I guess asking the last person leaving Silicon Valley to turn off the lights would be redundant.

David Wineberg
New York

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SHOOTING THE MOON

The True Story of an American Manhunt Unlike Any Other, Ever

By David Harris

Little, Brown & Co. • 394pp • \$26.95

GOING AFTER NORIEGA

In late December, 1989, six soldiers from Operation Just Cause—as the U.S. invasion of Panama was called—kicked open the door of General Manuel Noriega's office, hoping to arrest him. Instead, they found a good deal of cash, assorted pornographic materials and sex toys, a collection of porcelain frogs, and a framed picture of Adolf Hitler. There was also a Santería altar, upon which animal entrails had been arrayed in hopes of bringing ill fortune to several people listed on an attached piece of paper. Near the top of the list were the American prosecutor and Drug Enforcement Agency investigator responsible for chasing Noriega down—evidence of the high quality of Noriega's counterintelligence.

Ultimately, of course, Noriega was cornered in the Panama City papal embassy and flown to Florida, where he remains in federal prison, convicted of violating the Racketeer Influenced & Corrupt Organizations statutes. He is the only world leader ever captured and then brought to trial in the U.S. for violations of American law committed on his home turf. A three-man team of U.S. law-enforcement stalwarts managed to accomplish this long shot against the wishes of their superiors and other highly placed officials in the U.S. government. Just how they did it forms the central drama of David Harris' highly readable book, *Shooting the Moon: The True Story of an American Manhunt Unlike Any Other, Ever*.

Harris, a 1960s antiwar activist who has made a career as an investigative reporter and author, uses evocative language that often reveals his liberal leanings, referring, for example, to a Reagan Administration official as a "first-rate creep." His sympathies and gonzo prose style—along with his failure to represent adequately the "Reaganaut" point of view—may diminish the legitimacy of his book as a historical document. But for

the reader who can put up with occasional excesses, along with a large amount of detail, the story is riveting.

It's a tale ripe for the telling. As Harris reports, U.S. involvement in Central America during the 1980s featured a level of government corruption matched by few other recent affairs. Guns to arm the counterrevolutionaries against Nicaragua's Sandinista government were flown south on airplanes owned by CIA-run "cutout" companies, in contravention of federal law. Cocaine was the return cargo, bound for the States courtesy of the Colombian drug cartels. Profits were laundered in between, in Panama. (These events competed for headlines with a twin scandal involving gun sales to Iran, money from which also went to help the Nicaraguan contras.) These criminal activities weren't just taking place under the eye of the U.S. government: They were a government creation, and high-ranking officials were dedicated to protecting the efforts at any cost. The late CIA Director William J. Casey, Assistant Secretary of State for Inter-American Affairs Elliott Abrams, and National Security Council staffer Lieutenant-Colonel Oliver North together cooked up enough schemes to entertain conspiracy theorists for years.

The Contra intrigue and the case against Noriega were intertwined, sharing many of the same shady characters, mysterious airlines, and illicit banking arrangements. Indeed, Noriega's chief protectors in Washington were Casey and, initially, Abrams. Harris documents how, despite Noriega's many vices and a past littered with bodies, he had been considered a friend of the U.S. who, among other favors, helped facilitate secret support for the Contras and, inter-

estingly, aided an early phase of the drug war.

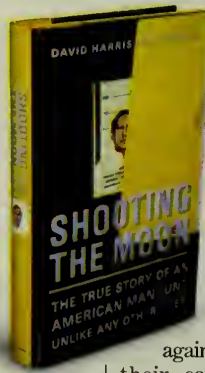
The initiation of what would become the Noriega investigation dropped out of the blue—literally—one day in 1989 when a light plane containing a shipment of smuggled cocaine made a forced landing on a Florida highway, nearly hitting a DEA agent's car. The pilot, proprietor of the air brokerage that included the plane ultimately became informants, revealing the identity of the plane's owner, a Panamanian named Floyd Carlton. Carlton, a Noriega henchman, was apprehended—and Dick Gregorie, first assistant U.S. attorney for the Southern District of Florida, persuaded Carlton to turn informant. The author portrays Gregorie as an intrinsically crime fighter who had made the war on drugs his personal *jihad*. He assigned a hard-working DEA agent named Sam Grilli to debrief Carlton. It was largely from Carlton's testimony that the case against Noriega was formed.

Harris chooses to focus on much of his story through the eyes of Grilli, who lived the Noriega case for a couple of years. Grilli, Gregorie, and Kennedy, the agent whose plane was almost hit by the Noriega plane and who was an integral member of the prosecution team, became victims of the intense internecine politics of the Noriega takedown. Noriega cause these three men perished and were succeeded by the wishes of their superiors, which clearly outrages the author.

Indeed, Noriega is far from the villain in this book. Casey is depicted as a master manipulator. But the real villain, according to Harris, is Abrams, drawn as an arrogant, Machiavellian paratchik, happy to do Casey's bidding when it came to using and protecting Noriega but an ardent Noriega-hater when the political winds shifted.

The heroes of the story—Gregorie, Grilli, and Kennedy—maintained their integrity amid the moral swamp. *Shooting the Moon* captures the flavor of the time and place. Its story is so wild that it couldn't have been made up.

BY MARILYN HARRIS
Harris investigated the Contra case in Central America for 60 Minutes.



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AMD 

BY STEPHEN H. WILDSTROM

tech&you@businessweek.com

THE NEW iBOOK IS MADE FOR STUDENTS



It still has youth appeal, but now it also has what students and educators really need

Apple Computer always swings for the fences. As Barry Bonds and Sammy Sosa know, the price of such ambition can be a strikeout. But when Apple connects, the ball goes a long, long way.

The PowerBook G4 Titanium, introduced early this year, redefined the laptop for creative professionals. The new iBook does the same for Apple's other crucial market, education. The iBook, richly featured and starting at \$1,299, is close to ideal for students.

The original iBook was also aimed at the student market. While it has some appealing features, I found it garish with curvy lines and bright colors. I also considered it underpowered and, at \$1,599 when introduced in 1999, overpriced. Despite the grouching of graybeards like me, it was an instant hit with the kids.

TOUGH. The new iBook is less dramatic but a lot more practical. Based on the reaction I've seen, it still has plenty of youth appeal. It's a rectangular white box, small enough to fit easily into a backpack and lighter than most textbooks (table). It features a full-size keyboard and a 12.1-inch display. Although it lacks the obvious rugged design of the original iBook, Apple says it has been engineered to stand hard knocks. The case, polycarbonate with a magnesium frame, looks tough, and the iBook lacks the fussy doors and latches that quickly break on many laptops.

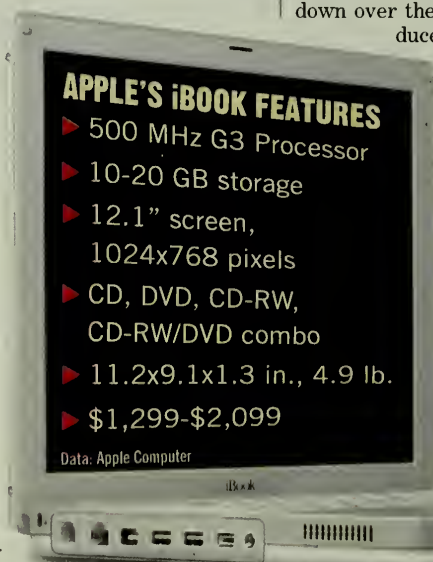
Apple devoted as much attention to how students use their notebooks as to how they abuse them. Perhaps most striking is the inclusion on the \$1,799 top-of-the-line model, of a drive that can play DVDs and read and write CDs. Such drives are immensely popular with those who use their computers both as tools and as entertainment centers. For once, Apple is offering such a high-end feature at a competitive price.

The iBook also comes with a full complement of ports for connecting with the outside world. Ethernet networks are pervasive at schools and colleges, and you get both a standard wired network jack and, as a \$100 option, an AirPort card for wireless Ethernet. Wireless is increasingly important as institutions from primary schools to universities make it possible to connect laptops just about anywhere. Unlike the nightmarish installation of AirPort on the Titanium PowerBook, setup on the iBook is a simple, no-torch chore. There is also a built-in modem.

For attaching accessories, there are two Universal Serial Bus ports plus a high-speed FireWire connector, which is especially good use with digital video cameras. Educators were unhappy with the original iBook's lack of external video and audio connectors, which prevented use with classroom monitors or projectors. Apple added them. About the only thing lacking is a slot for a PC Card, which could be useful for such things as connecting to a wireless phone network. The iBook has so many features built in that the slot is unlikely to be missed.

All of the ports are in a neat row on the side. No cable connections on the back mean that Apple could design a clever and well-protected buried hinge that allows the lid to fold down over the back when it is opened. This produces a very stable design and, as a bonus, a lower profile that will be handy for people using laptops in cramped airplane seats.

The iBook has a few flaws. The 10-gigabit hard drive is small for avid music or video collectors. A 20-GB drive is a \$100 option; more requires hooking up an external drive. The cheapest model comes with an inadequate 64 megabytes of RAM. A \$100 upgrade to 128 is required for decent performance. Battery life of about four hours is down about an hour from the original iBook because the design favors use of a smaller battery. But



is still exceptional for a notebook of this class.

The iBook comes with both Mac OS 9.1 and new OS X installed, but Apple wisely chose to make the older operating system the default. Buyers will have an instant upgrade to OS X once there's enough software available to make the switch worthwhile.

Apple lost a lot of ground in educational markets when good products couldn't overcome botched marketing. The new iBook ought to give it a chance to win schools back. And Windows laptop makers, who see the school and student markets as a potential source for growth, should take a close look at Apple's winning design.

BusinessWeek online

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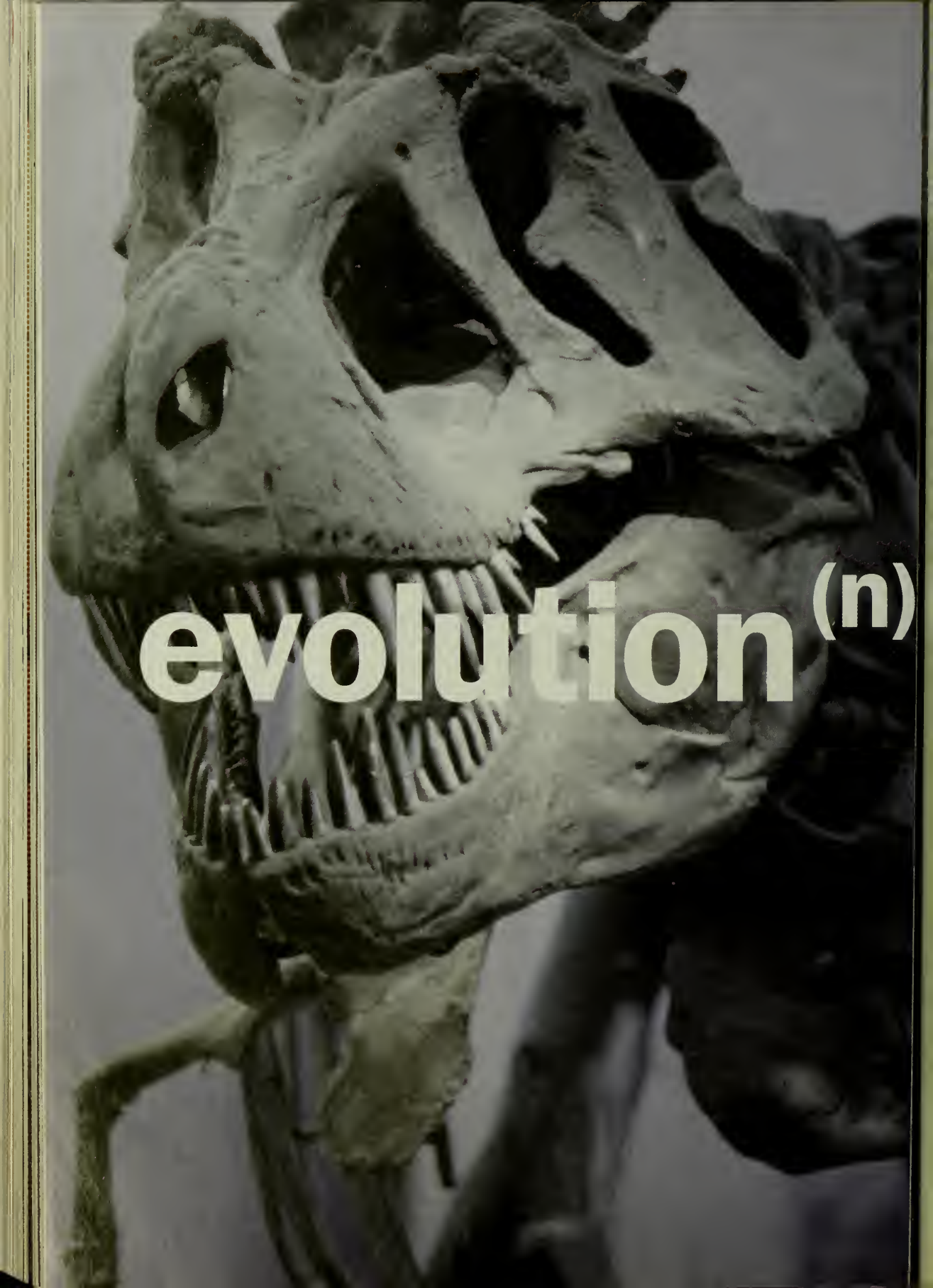

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BY ROBERT KUTTNER

THE TAX CUT ISN'T CARVED IN STONE



RECALL?
Not only can Bush's pride-and-joy be rescinded, but parts of it should be—and probably will be, if history is any judge

President Bush has won a resounding political victory with his \$1.35 trillion tax cut—for now. But most of the provisions may never take effect. The tax bill is heavily “back-loaded.” Only \$203 billion of the cuts actually apply between now and 2004. Most wait until after 2007. The cuts that take effect in the next three years are the relatively popular ones that provide modest benefits to most taxpayers. The ones that go primarily to the superrich kick in late in the decade.

Although Tom Daschle (D-S.D.), the new Senate Majority Leader, is making conciliatory noises, expect the Democrats to play hardball on taxing and spending as the elections of 2002 and 2004 approach. For example, an effective prescription drug program under Medicare would cost around \$80 billion a year. As they go into the 2002 elections, the top priority for Democrats will likely be a comprehensive drug benefit, paid for by rescinding narrow tax cuts that benefit exclusively the very wealthy, before those cuts ever take effect.

Another possible change in the tax bill just passed would be for the Democrats to strike a new bargain with the Republicans. In exchange for keeping relief from what the GOP calls the “death tax” on very large estates, the Democrats would insist on a remedy for what I’ve termed the “predeath tax” on the middle class. This is the “spend-down” of assets required to qualify for nursing-home care under Medicaid. Middle-class families spend down about \$30 billion a year getting rid of their worldly assets so that they can qualify for Medicaid. Don’t they deserve an exemption to protect their wealth and pass it down to the children as much as the very rich? This one should be a slam dunk for the Democrats.

Can we really think about rescinding part of the tax cut before the ink is dry? Ronald Reagan, who had far more of a mandate than George W. Bush, presided over a huge tax cut in 1981. But Congress then raised taxes three times, in 1982, '83, and '84, reversing some of the cuts. Why? Because even Reagan’s budget officials recognized that the excessive 1981 tax bill was causing unsustainable deficits.

VOODOO MATH? Congress acted in 1986 to close some of business’ favorite loopholes, and again raised taxes, in 1990, because of mounting deficits. That’s when George Bush Sr. had to eat his infamous words, “Read my lips, no new taxes.”

No tax cut is ever sacrosanct, and this one is particularly vulnerable politically. For starters,

the sanguine surplus projections may not hold. The huge state budget surpluses of recent years already are disappearing. Who can be sure a federal surplus will be there 10 years from now?

Then there is the issue of cost. The real year cost of the tax cut is well over \$2 trillion when you add increased interest on the national debt caused by the tax giveaways and expensive technical fixes that Congress ducked this time but must address soon. For example, the alternative minimum tax was intended to prevent the very rich from piling up loopholes. It currently hits fewer than 2 million taxpayers. The lower rate structure in the tax bill will exempt over 35 million households to the bite of the alternative tax. Everyone expects Congress to repeal this unintended consequence—but that will add \$300 billion to the bill’s 10-year cost.

CLASS POLITICS. Republican tax mastermind Grover Norquist persuaded business lobbyists to fall in line this year behind the Administration’s strategy of pursuing a clean bill, unencumbered by Christmas tree special-interest provisions. In return, he promised business groups and supply-siders that they would get their reward next year—capital-gains cuts and corporate breaks. “This is just the beginning,” he said. “We’re coming back for more.”

Then, of course, Bush also wants partial privatization of Social Security, which would diminish much more of the surplus—up to \$1 trillion.

In the end, the provisions of the tax bill have the weakest political traction may never take effect. Rather than adding more cuts for the rich, Congress could well repeal some. The reconciliation bill will include fiscal moderates worried about budget balance and liberals who want less tax relief for the affluent and more popular social spending for the middle class. Just last month, the Republican-controlled Congressional Budget Office reported that from 1979 to 1997, inflation-adjusted incomes of the wealthy Americans increased by more than 100%, while middle-class incomes grew by 10%, and incomes of the poor declined. So, when taxes are discussed next time around, class politics could help the Democrats.

For now, the Republicans insist that the tax cut is impregnable. But even tax cuts are not sacrosanct. Democrats were also in shell shock during Reagan’s first year, yet by 1982, they had recovered their wits. This time, the defection of Sen. James M. Jeffords (I-Vt.) is their tonic. Just as the tax cut is back-loaded, President Bush’s political triumph may be front-loaded.

Robert Kuttner is co-editor of *The American Prospect* and author of *Everything for Sale*.



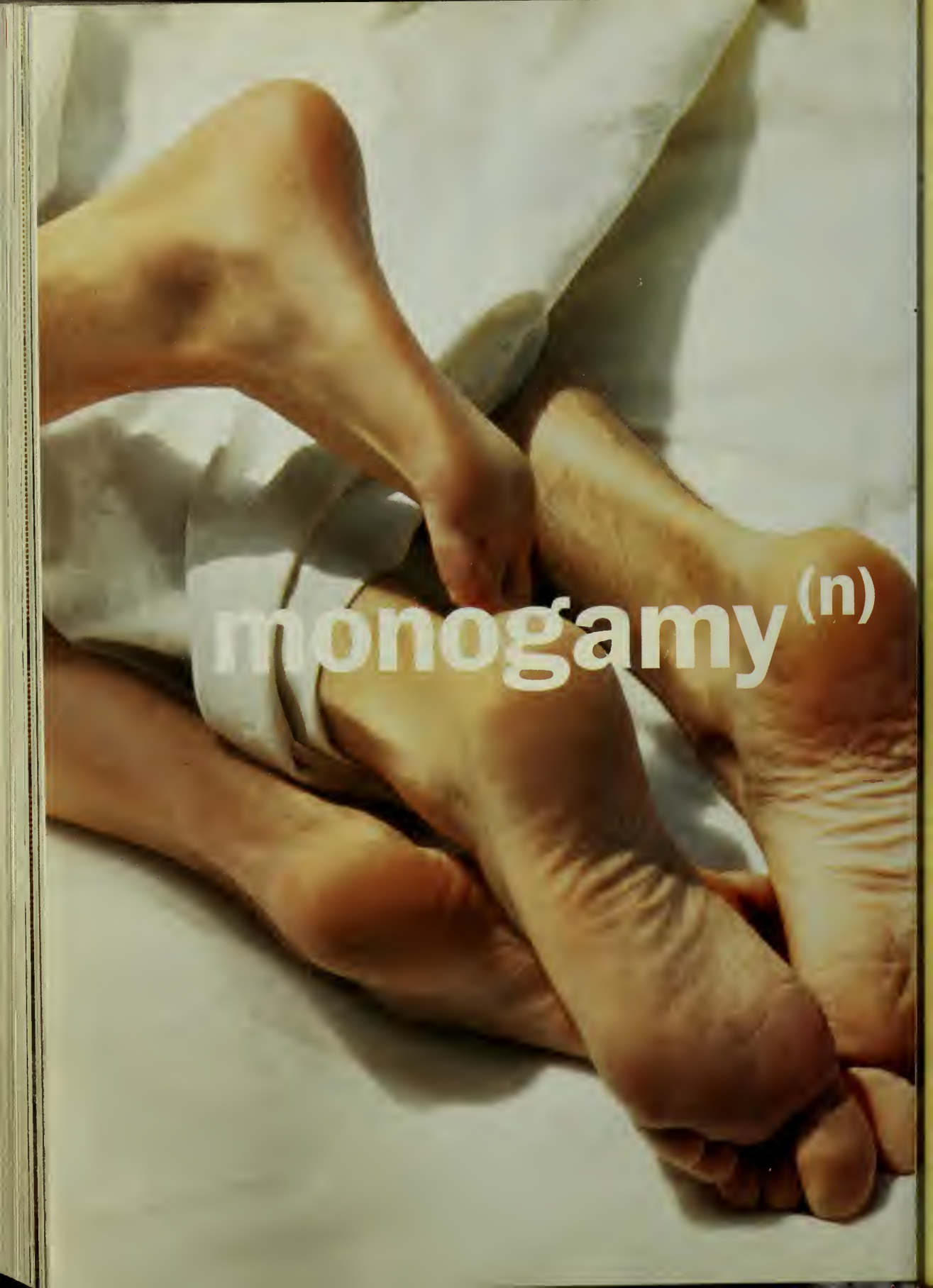
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BY GENE KORETZ

LOW INFLATION— AND LOW PROFITS

The impact of wilting pricing power

Federal Reserve Chairman Alan Greenspan's recent remark in a speech in Singapore that "inflation is not a significant problem at this moment" hasn't allayed the fears of inflation hawks. Even if the economy bounces back by early next year, as the stock market revival implies, many still worry that rising energy prices and surging unit labor costs (up at a 6.3% clip last quarter) could spark a pickup in inflation.

Economist Stephen Roach of Morgan Stanley Dean Witter & Co. is dubious, however. "The lack of pricing leverage,

price inflation and increases in unit labor costs and producer prices has either widened or stayed stable in recent years. In other words, he says, "the U.S. stands largely alone in experiencing a loss of pricing leverage."

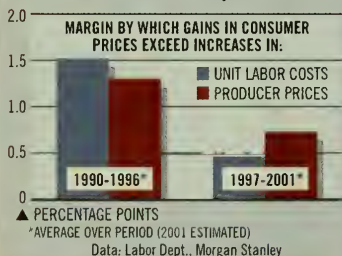
What accounts for this disparity between the U.S. and other advanced nations? The strengthening of the dollar, which has enabled other nations to undercut U.S. prices more easily, is one key factor, Roach believes.

But another, he argues, has been America's lead in market deregulation and in cracking the rigidities of union-dominated labor markets. The competition spawned by such changes—along with the competitive pressures unleashed by the strong dollar, globalization, and the technology revolution—have all sapped U.S. business' traditional ability to raise prices.

Oddly enough, Roach finds that some of other nations' apparently greater pricing leverage stems from recent disinflation overseas in both labor costs and producer prices—suggesting that continuing deregulation in product and labor markets is starting to reduce many foreign companies' costs. As trade liberalization and globalization continue, however, he predicts that such companies will also face a decline in their own ability to pass on costs.

For now, however, the message of America's lack of pricing leverage seems twofold: It suggests that earnings will remain seriously constrained even if the economy picks up steam—and that the U.S. will be more of a disinflationary place than the rest of the world.

U.S. BUSINESS: CAUGHT IN A COST SQUEEZE



particularly among U.S. companies," he says, "is a hallmark of today's economic environment that is likely to keep inflation at bay for some time."

Pricing leverage, of course, refers to the ability of companies to pass on cost increases via higher prices for their products and services. To show how such leverage has changed, he compares the gaps between average increases in consumer prices and increases in both labor costs and producer prices in two periods: 1990 to 1996 and 1997 to 2001.

In the first period, average annual rises in the consumer price index exceeded gains in unit labor costs and producer prices by 1.5 and 1.3 percentage points, respectively. Since 1997, however, these percentage-point spreads have shrunk to 0.47 and 0.73—pointing to a loss of pricing leverage that was less crucial for profits when the economy was in overdrive but now looms as a major hurdle for business.

Meanwhile, Roach's analysis of similar data for other industrial nations indicates that the gaps between consumer

THE HEALTH COSTS OF BEING FAT

They may rival those of smoking

Ask Americans which behavioral problem most threatens their physical and economic health and they are likely to answer smoking or drinking. According to a study in the British journal *Public Health*, however, the behavior leading to obesity—poor eating habits and lack of exercise—may well represent a larger potential threat to the public's health and well-being.

The study by Rand Corp. researchers Roland Sturm and Kenneth Wells is the first to compare the negative health effects of obesity with those of smoking, heavy drinking, and poverty. Based on a nationwide survey of some 10,000 people, it finds that 36% of adult Americans

are overweight (20% to 30% above normal) and 23% are obese (more than 30% heavier than normal). By contrast, only about 20% of adults are daily smokers and 6% are problem drinkers.

More important, the results of the study indicate the health risks of obesity are actually as great and often considerably greater than those caused by either smoking, heavy drinking, or poverty. That is, obesity is associated with just as many or more chronic conditions like diabetes, asthma, heart disease, and arthritis, and its impact on a person's ability to perform common tasks such as climbing stairs or carrying packages is at least as great.

Can the obesity epidemic be stopped? Economists have related the rise in obesity to changing incentives—the declining cost of food, the shift to more sedentary employment. While countering these incentives is difficult, the authors note that public education and other initiatives have helped to dramatically reduce the incidence of smoking in recent decades. It's time, they believe, to mount similar efforts to combat obesity.

WHERE EXPATS SPEND THE MOST

Asian cities, Moscow, and London

For U.S. executives working overseas, the priciest places to live are Seoul, Tokyo, Moscow, Singapore, and London. That's the finding of Runzheimer International's latest survey of living costs around the globe, based on the needs of a middle-class U.S. family.

The most surprising aspect of the

report in view of the superstrong dollar is the high relative cost of living for executives working in New York, which ranks fourth in a list of 25 cities. (New York is also about 45% more expensive than Chicago.) Some of the cheapest postings this year are Sydney, Bombay, Toronto, and especially Johannesburg—where living costs currently run about 60% below those of the Big Apple.

LIVING COSTS AROUND THE GLOBE



*FOR 3 PERSON U.S. FAMILY
\$100,000 INCOME LEVEL
Data: Runzheimer International

JAMES C. COOPER & KATHLEEN MADIGAN

RECESSION? CONSUMERS AREN'T BUYING IT

Their spending, fueled by tax and interest-rate cuts, will likely continue

U.S. ECONOMY

If the U.S. is in a recession, someone forgot to tell consumers. True, they're not binging as they were a year ago, but households are hanging in there, and a recession has never occurred without an outright drop in consumer spending. Despite all the dour economic headlines, the latest retail sales data suggest that the will to spend is still strong.

But do consumers have the means to keep on buying? That's the crucial question for the outlook. Their finances have been hit by the plunge in stock prices, a weaker job market, rising debt burdens, and a negative interest rate. Yet despite those hammer blows, buyers seem to have the wherewithal to keep shopping.

For one thing, rising home values are offsetting the drop in stock portfolios, and wages are still increasing faster than inflation, adding to household buying power. Also, the decline in the saving rate was concentrated among upper-income households. Lower-income families actually have increased their savings from the pace of the early 1990s.

Moreover, finances will get a lift from the tax rebate cuts in payroll withholding rates. And financing costs will drop as a result of the Federal Reserve's cuts in interest rates.

While laid-off workers are facing tough times, and economic pain should not be minimized, the consumer sector in general seems healthy enough to buoy the economy in the second half. Increased spending should offset the brakes on growth from declining capital outlays and an inventory correction. Those two factors could cause a drop in second-quarter real gross domestic product, but growth should firm up as long as consumers soldier on.

SHOPPERS HELPED TO SUPPORT

economic growth in the spring, according to the data on retail sales and services, the Commerce Dept.'s new measure of buying activity based on its revised classification system. Sales surged by 1.4% in April and edged up another 0.1% in May (chart). Sales at gasoline stations rose strongly, mostly reflecting higher gas prices. But sales in selling furniture, groceries, sporting goods, and

hobby equipment also posted large May gains.

The increases in April and May retail buying suggest that real consumer spending is growing at an annual rate of about 1.5% in the second quarter. That would be the slowest pace in nearly six years and far below the shop-till-you-drop record pace of 7.6% set in the first quarter of 2000. The slowdown is probably temporary, though, and spending should pick up somewhat once taxpayers start receiving their rebate checks.

Consumer spending hasn't declined outright, in part because wage growth remains quite healthy even in the face of rising layoffs. In the first two months of the second quarter, nonfarm payrolls fell an average of 101,000 per month, but wage growth still climbed 4.3% from the

year before, or about one percentage point faster than inflation, even with the recent jump in gas prices.

To be sure, the unemployment rate will increase as the year wears on and as companies cut labor costs to salvage profits. But the job market may not loosen enough to make much of a dent in wage growth, which tends to lag behind the ups and downs of real GDP. And once the economy picks up, businesses will be looking to hire workers again. Increased labor demand will keep wages growing at a healthy pace that will continue to support consumer spending.

EVEN SO, households aren't immune to news about corporate job cuts. And some may be curtailing spending in order to save more for a rainy day. The U.S. saving rate has been falling sharply since 1998 and turned negative in mid-2000. On the surface, that suggests that consumers have little cushion against hard times.

But fears of cash shortages may be exaggerated. A Fed study by Dean M. Maki and Michael G. Palumbo shows that the drop in the saving rate was concentrated in the households most able to cut back on savings (table). According to the study, households in the top 20% of income-earners—with annual incomes of about \$79,000 or more—reduced their saving rate from 8.5% in 1992 to -2.1% in 2000. The next highest 20% also saved less, but their saving rate remained positive. Surprisingly,

WHO CUT BACK THE MOST ON SAVING

INCOME BRACKET	INCOME RANGE*	SAVING RATE	
		1992	2000
TOP 20%	\$79,376+	8.5%	-2.1%
FOURTH 20%	50,521-79,375	4.7	2.6
MIDDLE 20%	32,001-50,520	2.7	2.9
SECOND 20%	17,197-32,000	4.2	7.4
BOTTOM 20%	0-17,196	3.8	7.1
TOTAL U.S.		5.9	1.3

Data: Census Dept., Federal Reserve

*1999 data

RETAIL SALES KEEP CLIMBING

TOTAL RETAIL AND
FOOD SERVICES



Business Outlook

households in the bottom 60%—making \$50,000 or less—are saving more of their income than they did eight years ago.

One reason that upper-income families cut back is that they accumulated new wealth from the capital gains of their considerable financial assets. They didn't need to save from their current income to raise their net worth because the soaring stock market was doing the job for them. Lower-income people, on the other hand, hold fewer financial assets. So they may have recognized the need to save more as a hedge against hard times. Viewed in this way, both sets of households acted rationally, with the net result that the overall saving rate dropped sharply during this expansion. Despite the decline, the most economically vulnerable households have some additional financial leeway.

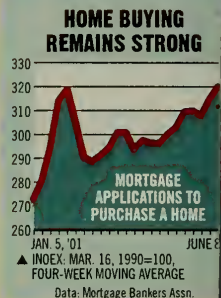
THAT COULD BE IMPORTANT during this rough economic patch. New claims for jobless benefits have risen over the 400,000 mark, a level usually associated with recession. And the delinquency rate for some of the riskiest mortgages is rising.

In addition, households are carrying a record debt burden, which puts a strain on monthly budgets. Installment credit jumped \$13.9 billion in April, led by a huge advance in revolving debt, which includes credit cards. Total debt outstanding equals 21.9% of disposable income, the highest ratio ever.

Because the Fed no longer breaks down the credit numbers, it's difficult to say whether debt is rising because consumers are having trouble paying down their credit-card bill or whether households feel secure enough about their economic future that they aren't worried about taking on more debt.

One sign that consumers still are upbeat is the continued increase in home-buying. In mid-June, applications for mortgages to purchase a home were at their highest level in six months (chart). Homeownership is a key source of consumer wealth, and home values have been rising even as stock prices have tumbled.

While news on the consumer front is reassuring, that does not mean the outlook is free of risks. A plunge in stock prices or sharp deterioration in the labor markets could shake consumer confidence, and spending could drop. Even with stimulus coming from both tax cuts and low interest rates, neither outcome seems likely in the second half. And bear in mind that consumer spending accounts for two-thirds of real GDP. So if anyone is going to spread the word about recession, consumers will be the ones shouting the loudest.



AUSTRALIA

A TIMELY UPTURN FOR CANBERRA

Australia's economy has taken a turn for the better, which is especially welcomed by the conservative coalition of Prime Minister John Howard. Facing expected elections by yearend, his government trails the opposition Labor Party and its leader, Kim Beazley, in the polls.

The polls register a response to the unpopular 10% goods-and-services tax (GST) imposed by the government last July and its impact on the economy. The GST's jolt to housing and consumer spending led to an unannualized 0.6% drop in fourth-quarter real gross domestic product, raising fears that the economy had fallen into a recession.

But in a surprisingly strong re-

bound that assuaged those worries, first-quarter real GDP jumped 1.1%, as consumer spending surged. To soften the GST's initial blow, the government had paired the levy with a tax cut that the majority of households chose to save—until now.

Housing also is set to recover. Home-loan approvals rose in April, after a March gain that was the largest in nine years. Because the GST taxed building materials for the first time, housing

activity went from boom to bust, temporarily depressing overall growth. The economy grew at only a 0.4% annual rate in the second half of 2000, but excluding housing, growth was a healthy

4.3%, according to economists at J.P. Morgan Chase & Co.

Other growth fundamentals are favorable: The Reserve Bank of Australia cut interest rates aggressively earlier this year. The cheap Aussie dollar supports exports, and budget policy is stimulative. Plus, first-quarter GDP rose despite a huge drag from inventory liquidation, which clears the way for future output gains.

Still, the economy—and the government—may not be out of the woods. The jobless rate rose to 6.9% in May, a 20-month high and is expected to pierce 7% as elections near. But the biggest threat lies offshore. Australia's commodity-intensive economy is dependent on exports, some 60% of which go to Asia. Asian growth is slowing, however, and Japan appears to be in a recession again.

JOBLESSNESS IS SET TO RISE FURTHER



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BUSH'S SOFTER SELL



The White House says its marketing, not its policies, need work

Listen to a barnstorming George W. Bush these days, and you might conclude that he is moving away from the hard-edged conservatism of his initial months in office and shifting more toward the political center. When the President brings up the energy crisis, as he did on June 12 in Madrid, he speaks reverently of conservation, efficiency, and clean technologies that bypass fossil fuels. When Administration officials bring up environmental safeguards, they don't mention how they quickly rescinded Bill Clinton's strict standards on traces of arsenic in drinking water. Instead, there is glowing talk about developing a benign New Environmentalism that protects kids from toxins in the air and water while preserving workers' jobs. On foreign-policy issues, Bush has retreated under friendly fire from his original positions on America's role in the Middle East, the Balkans, the Korean peninsula, and International Monetary Fund bailouts. The new mantra for U.S. allies: Consult, consult, consult.

What seemed like the Bush Administration's black-and-white world view is suddenly taking on a thousand shades of gray. After the customary

honeymoon, the President is suddenly coming face to face with a myriad of real-world policy challenges that aren't going to go his way easily. And despite an impressive victory on his tax cut, Bush is grappling with a reality faced by every new President: how to deliver on bold campaign promises when faced with the inevitable, conflicting tug to move more toward the center to govern effectively. Bush's job is complicated all the more by Vermont Senator James M. Jeffords' defection from the Republican Party, prompting a Democratic takeover of the Senate. The shift means that a Bush team noted for saying "my way or the highway" now has to accept more legislative compromise—at the risk of alienating core conservatives.

If Bush doesn't compromise, the chances of angering middle-of-the-road voters are just as high. Bush is suddenly facing a swoon in his job-approval ratings—and the dip is particularly acute among moderate and independent voters. A survey by Lansing (Mich.) polling firm EPIC/MRA in the key swing

state of Michigan found that Bush's support is plummeting in key voting blocs. Among independents, his approval rating dropped from 62% to 51% from February to May, and his disapproval rating soared from 20% to 43%. Among middle-class voters earning \$45,000 to \$60,000 a year, his approval rating slid from 65% to 43%, while those disapproving of Bush leapt from 21% to 50%. "Issues such as arsenic, Arctic drilling, abortion, energy, and the environment are defining Bush in much the same way as gays in the military and health care defined Clinton," says EPIC/MRA Vice-President Ed Sarpolus.

What's more, as Bush discovered he began his four-day European tour

A TUG TO THE CENTER?

Don't count on it.

Despite opposition abroad and the shift of power back to the Democrats in the Senate, for the most part, Bush is sticking to his conservative agenda.

ENERGY Although the Administration's energy plan was a political flop, it will continue to focus on oil, gas, and coal production. The White House has added measures encouraging conservation and efficiency, but the move hasn't convinced independent voters that Bush is serious about such alterations.

GLOBAL WARMING Bush isn't backing down from his opposition to the Kyoto accord. But he could alienate voters, and even the business community, if he doesn't come up with a strong alternative to combat greenhouse gas emissions.

merica's allies strongly oppose what ne European Union leaders consider lical and unilateral Administration sitions on arms control, missile de- se, capital punishment, and global rming (page 36). "This is a cross- ds for Bush," says independent poll- r John Zogby. "He's on the defen- e, and he's hurting in the [political] iter."

So does that mean the President is ving toward the middle much as Clin- did following the Republican land- e in 1994? Hardly. The President's ing popularity and his weakened po-

tune-up of the White House's public-re- lations strategy. To put this political co- nundrum in business terms, Bush Inc. feels it has a marketing problem, not a defective product.

But some political pros caution that such a stance risks hanging on too long to a losing hand. Republican moderates are already begging the White House to heed their concerns on the environment, energy, and social spending. And Hill Republican leaders—worried about sur- rendering control of both houses of Congress in 2002—may rush to the center with-

on on Capitol Hill are pushing the ite House to moderate its tone and ch out more aggressively to inde- dents and partisan Democrats alike. if you think the new, softer rhetoric ks the dawning of a second, more trist Bush Administration, you're ly to be mistaken.

For starters, key White House offi- s, among them top strategist Karl e, continue to believe that in the rmath of the Clinton era of moral tivism, a principled form of stub- ness on the new President's part ultimately be seen as a virtue. Bush figures that the more he tacks right is demands, the less ground he will e to give up during eventual com- nises with the Hill. Bush "cam- ned on certain causes," insists White se Chief of Staff Andrew H. Card "We're going to remain tunnel-vi- " true to those positions.

fficially, Bush's lieutenants insist the current downdraft in Presiden- popularity can be fixed via a little

out him. "Only after that midterm election debacle [in 1994] did President Clinton start heading to the middle," notes Charles Cook, an expert on congress- sional politics. "The question now is whether the Bush White House will wait for a midterm election disaster be- fore it snaps out of this."

Indeed, if the political ground shifts under Bush's feet as panicked congress- sional Republicans veer toward the middle, he risks irrelevance—or worse. Still, by doggedly sticking to his guns on core issues—from energy to gun control to abortion—Bush hopes to re- tain the loyalty of the social and economic conservatives who form the heart of his party. The White House hopes that by adopting more of a soft-sell ap-

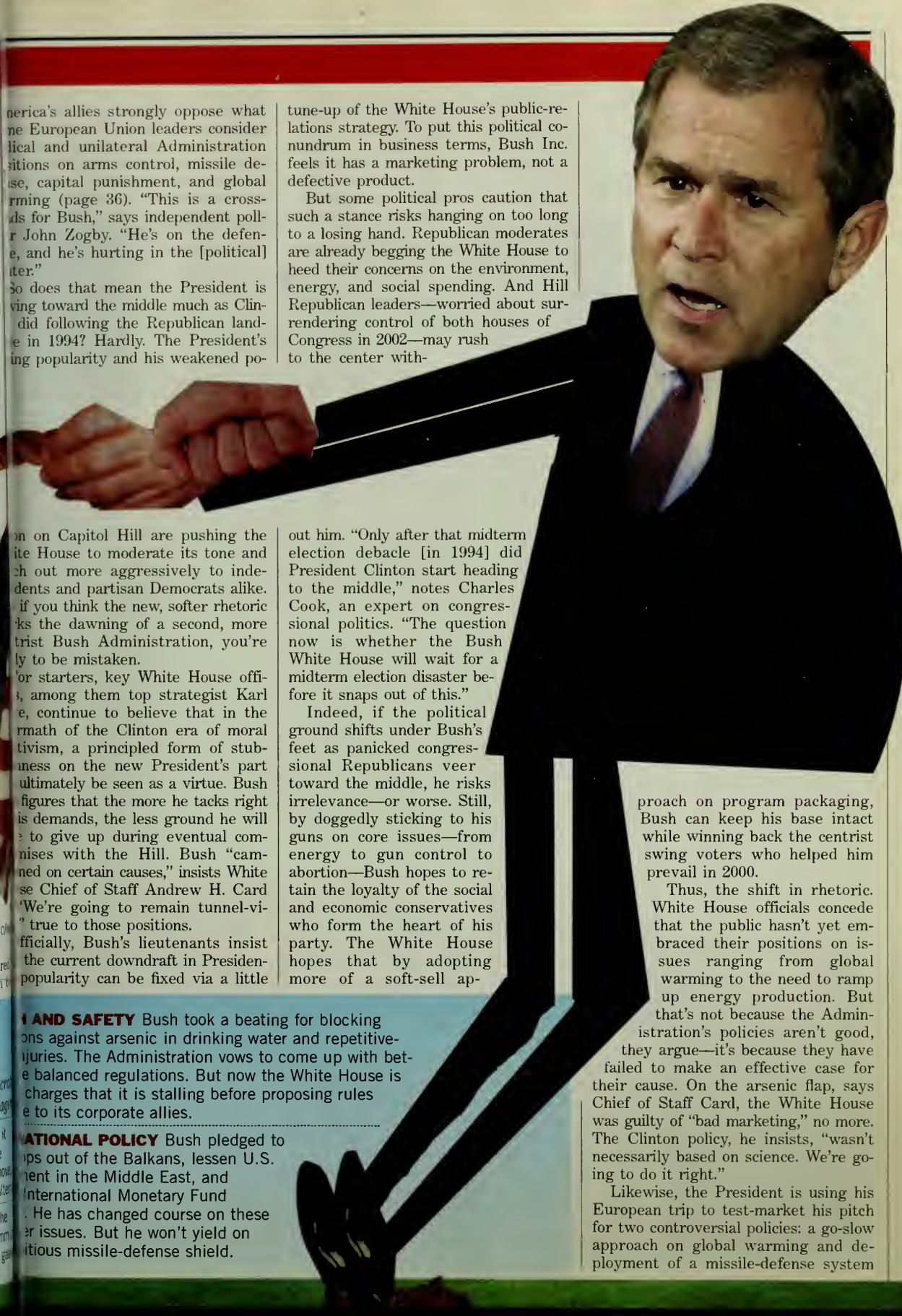
AND SAFETY Bush took a beating for blocking ons against arsenic in drinking water and repetitive- injuries. The Administration vows to come up with bet- e balanced regulations. But now the White House is charges that it is stalling before proposing rules e to its corporate allies.

NATIONAL POLICY Bush pledged to ps out of the Balkans, lessen U.S. ent in the Middle East, and ternational Monetary Fund . He has changed course on these r issues. But he won't yield on itious missile-defense shield.

proach on program packaging, Bush can keep his base intact while winning back the centrist swing voters who helped him prevail in 2000.

Thus, the shift in rhetoric. White House officials concede that the public hasn't yet embraced their positions on issues ranging from global warming to the need to ramp up energy production. But that's not because the Admin- istration's policies aren't good, they argue—it's because they have failed to make an effective case for their cause. On the arsenic flap, says Chief of Staff Card, the White House was guilty of "bad marketing," no more. The Clinton policy, he insists, "wasn't necessarily based on science. We're going to do it right."

Likewise, the President is using his European trip to test-market his pitch for two controversial policies: a go-slow approach on global warming and deployment of a missile-defense system



that would effectively kill the 1972 Anti-Ballistic Missile Treaty. While the immediate reaction abroad was frosty, Bush is convinced that ultimately, he will be viewed as a principled visionary—at least by voters at home, if not across the Pond.

This damn-the-torpedoes attitude doesn't mean the Bush Administration is

prepared to march off the cliff for every conservative cause. Already, the President has signaled that he will sign an education-reform package that does not contain his much-coveted plan to provide government vouchers for private schools, an idea that was defeated by the Senate on June 12.

Several upcoming decisions will make

it difficult for Bush to have it both ways, however. By early July, the Administration is scheduled to decide whether the government should fund stem-cell research that has proven promising in finding possible cures for some chronic diseases. Health & Human Services Secretary Tommy Thompson and many pro-choice H

COMMENTARY

By Paul Raeburn

GLOBAL WARMING NEEDS MORE THAN JUST ANOTHER STUDY

On the eve of his first trip to Europe as President, George W. Bush unleashed a torrent of anger from environmentalists and Europeans by digging in his heels on global warming. When a much-anticipated scientific report ordered by the White House confirmed the global-warming threat, Bush responded only with a call for "more research." That was hardly what environmentalists or Europeans—plagued by foot-and-mouth disease, mad cows, and unprecedented storms—wanted to hear. To the contrary, of the subjects Bush planned to address in Europe, "the environment is the big issue" a senior French official said. "Missile defense is years away, but people are already feeling threatened by environmental problems."

Still, Bush did make an important concession in his June 11 Rose Garden speech. For the first time, he accepted the scientific consensus on global warming—a consensus that doubters on the right, not to mention Bush himself, have questioned. "We know the surface temperature

of the earth is rising," Bush now says. "Concentrations of greenhouse gases, especially carbon dioxide, have increased substantially since the beginning of the Industrial Revolution. And... the increase is due in large part to human activity." That's as clear a statement of the problem as any politician has provided, and it's all the more surprising from an Administration with closer ties to business interests than to environmental groups.

UNFAIR. What's less clear is whether Bush is serious about realistic solutions that would address the problem. Even as he embraced the science of global warming, he reiterated his opposition to the 1997 Kyoto Protocol. He believes that its emission limits cannot be met without damage to the American or global economy. What he didn't do is come up with any alternatives, causing critics in Europe and elsewhere to charge that he is just stalling.

Rather than propose an alternative to

Kyoto, Bush has instead created a U.S. Climate Change Research Initiative, to be headed by the business-trade-oriented Secretary of Commerce Donald L. Evans. The initiative's charge is to boost research on global warming during the next few years and work with allies to do the same. The problem is it sets no timetable for putting policies into

effect. No one disagrees that scientists have a lot to learn. Respected climatologists such as Richard S. Lindzen, a climatologist at Massachusetts Institute of Technology, point to uncertainties in predictions of future warming. Other analyses estimate that temperatures could rise by 2.5F to 10.4F by 2100. This spread suggests how much scientists still do not know. They don't understand, for example, how changes in humidity, ice cover, and cloud cover could speed up or ease the temperature rise. And even the best climate predictions are limited by

uncertainties, such as population growth, energy use, and unforeseen technological changes.

On the increased Melting glaciers, flooding, and droughts

GLOBAL WARMING

What we know about it.

The White House asked the National Academy of Sciences to identify "the greatest certainties and uncertainties" in the science of climate change. Here are excerpts from the academy's June 6 report:

► Earth's temperature rose 0.7F to 1.5F during the 20th century

► Most of the warming stems from a rise in concentrations of greenhouse gases, including carbon dioxide

► Before the Industrial Revolution, atmospheric carbon

dioxide levels were typically 190 to 280 parts per million by volume (ppmv). By 1958, they were 315 ppmv. They are now about 370 ppmv and rising 1.5 ppmv per year.

► Human activities are responsible for the increase. The primary causes are burning oil, gas, and coal.

► Computerized predictions of climatic change suggest that the earth's temperature will rise a further 2.5 to 10.4F by 2100. The consequences would include shrinking glaciers, disrupted agriculture, flooded coastal regions, and the increasing likelihood of droughts.



Republicans favor federal funding, but anti-abortion activists and White House political advisers oppose allowing scientists to work with fetal tissue. In the end, Bush will anger either his party's core or swing voters.

In another tough call, the White House has to decide whether to launch an all-out offensive to reshape the fed-

eral judiciary through the appointment of conservatives. Such a push, while pleasing the GOP's right flank, could face serious resistance in the Senate and alienate centrists. The key issue: How many principled defeats of hard-line nominees can Bush take before he looks politically vulnerable?

The White House is betting that its

new focus on smooth salesmanship will help the President hang on to the affections of centrist voters. But even for a crew that swears it never scans the polls, the recent dive in Dubya's job ratings has to be unnerving. Because if those ratings don't improve soon, it's back to Square One for a President who likes to say his policies are "just right" for America.

*By Richard S. Dunham
in Washington*



Bush already has plenty of the resources needed to craft a policy. He did in his speech to a 28-page report on global warming prepared by the National Academy of Sciences at the request of the White House and released on June 6. The report summarizes what is known about global warming, and, equally important, it addresses the uncertainties. One of the main uncertainties is what scientists generally agree on: Greenhouse gases are accumulating in the atmosphere as a result of human activity. Carbon dioxide has increased beyond levels seen before the Industrial Age. Typically, levels of carbon dioxide range from 190 to 280 parts per million by volume (ppmv) during so-called interglacial periods, but during the period we're in now. By 2100, however, atmospheric carbon dioxide could have risen to 315 ppmv. It is currently at 370 ppmv and climbing at about 5 ppmv per year. Human use of coal, oil, and gas is the primary cause. Furthermore, these and other substances trap heat in the atmosphere, and car windows trap heat in a parking lot—the so-called greenhouse effect. Temperatures have risen 7F to 1.5F in the past century. According to the report, most warming during the past 50 years "is likely to have been due to the increase in greenhouse gas concentrations."

IN BRUSSELS

Will Europeans abide by the Kyoto Protocol without the U.S.?

None of this constitutes absolute proof that greenhouse gases caused the temperature rise. But the science does tell a compelling story. And many scientists, environmentalists, and business leaders have concluded that it is time to act: If current predictions are roughly correct, the warming could lead to changes in growing seasons, widespread droughts, coastal flooding, and even catastrophic changes in weather.

EXEMPTIONS. Nor does the report necessarily suggest that the Kyoto pact, unchanged, is the best route forward. Even supporters acknowledge that Kyoto is a far more problematic and costly solution than envisioned when negotiated. For one, it exempts developing countries such as India and China from binding emissions limits, a compromise adopted with the understanding that such limits would be added later. Without them, the pact appears to put an unfair burden on industrialized countries. And Kyoto does not provide for emissions trading—giving the U.S. or European countries emissions "credits," for example, for building clean power plants in developing countries.

What can be done? Bush is not like-

ly to drop his opposition to the Kyoto accord, but Europeans believe it is an important first step and can be used to fashion an effective treaty. And publicly, they remain fully behind it. "The European Union and its members will fulfill the obligations we have undertaken with Kyoto," says Jürgen Trittin, the German Environment Minister. Still, no European country has ratified the treaty either, and some may be pleased to see Bush receive all the criticism for rejecting a treaty they too would have difficulty implementing.

The question now is whether Bush, through his new task force, will develop policies that begin to address these issues. One possibility would be to suggest ways to refashion the treaty to improve it, rather than to abandon it altogether. Even Treasury Secretary Paul H. O'Neill has urged Bush to develop "a catalogue of possible options" to address global warming. Those could include taking steps to boost energy efficiency, a move that could have benefits elsewhere in the economy while it reduced emissions. A proposed bill to raise fuel-efficiency standards for sport-utility vehicles, approved by the House Appropriations Committee on June 12, would fit squarely into such a strategy.

To restore U.S. credibility on the issue, Bush needs a comprehensive set of proposals to deal with global warming. If he lets the new research task force drag on for more than a few months without answers, it will be clear that he is merely stalling. In the Rose Garden speech, Bush said, "While scientific uncertainties remain, we can begin now to address the factors that contribute to climate change." Many of his critics agree. What, then, will the U.S. begin to do? That's what the President did not say.

With Lorraine Woellert in Washington and bureau reports

COMMENTARY

By Michael J. Mandel

IN A ONE-WORLD ECONOMY, A SLUMP SINKS ALL BOATS

Anywhere you look around the globe, the stream of bad economic news is unrelenting. On June 7, the British government released data showing that industrial production had fallen for three months in a row. The next day, Germany announced its second straight month of industrial decline. Then, on June 11, word came that the Japanese economy had unexpectedly contracted in the first quarter. Meanwhile, U.S. growth is flat, at best.

Coincidence? Hardly. With the global economy increasingly integrated, there are signs that the business cycle has gone global as well. In the not-so-distant past, business investment, residential construction, and consumption were only slightly synchronized across countries. When one region was weak, another was usually strong. As a result, global recessions were rare events, unless they were the result of major global shock such as the oil price increase of 1973.

But in the Internet Age, countries are becoming more and more connected—not only by trade but also by capital markets, by the flow of technology and ideas across national borders, and by psychology. Rather than rising and falling separately, national economies increasingly respond to the same forces.

The clearest evidence: A worldwide



slowdown in domestic demand—the category that includes investment, consumption, and government spending. In Europe, domestic demand grew at a 0.4% pace in the first quarter, down from about 3% a year earlier. U.S. domestic demand is rising at a 0.2% pace, and Japan is flat.

This coordinated slowdown is much different than in the past. For example, in 1986 and 1987, business investment declined in the U.S. But that slump did not spread to Europe, where capital spending grew in excess of 6% annually. On the other hand, in 1993, business investment soared in the U.S. while it fell in Europe and Japan. Similarly, residential construction and consumer spending have generally been out of step across countries.

That's a key reason many people expected that increased globalization and

trade would smooth ups and downs of an individual country's business cycle. A nation facing slowdown at home could export more to other parts of the world while adding up on imports. That fact, was often given as one of the reasons why the New Economy should be less affected by recession.

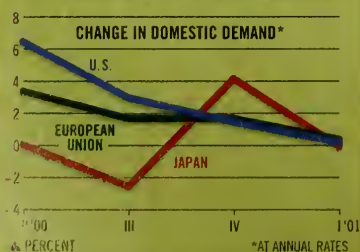
In fact, the opposite has turned out to be true, as tighter ties between countries cause downturns to spread faster. In part, the slump in tech spending and other business investment has spread quickly from the U.S. to the rest of the world. First-quarter capital spending fell at a 4% annual rate in Japan compared with a 2% decline in the U.S. Meanwhile, according to Eurostat, the European statistics agency, reported total residential and business investment fell at a 3% pace in the first quarter. Companies such as Siemens and Bosch are among those that have cut back on investment in full swing in Europe.

In part, this weakens the fact that many countries have become increasingly dependent on exports to the U.S. to drive growth, making them vulnerable to any American slowdown. For example, European exports to

the U.S. have more than doubled since 1993. So when U.S. demand for European goods fell sharply in the first quarter, European companies had less to add new manufacturing capacity. The same forces are holding down Japanese investment, since U.S. imports from Japan fell at a remarkable 35% annual rate in the first quarter of 2001.

But nontrade links between national economies have been getting tighter. Take capital markets. Stock markets in different countries have

A SYNCHRONIZED SLOWDOWN



Data: DRI, Bureau of Economic Analysis

each other, as in the case of crash. But with investors moving across national borders more and more, the movements of one country are being felt quickly in bourses worldwide. The economic consequences, as on Wall Street, for instance, spread down other markets around the world, depriving companies of the needed for capital spending. The fall in the Standard & Poor's index this year has been mirrored by similar drops in the London, Frankfurt, Paris, and Tokyo stock

R. While the U.S. is the epicenter of the tech stock bust, the dot-com New Economy stocks has been dropping precipitously overseas. The Nasdaq is down 14% since the beginning of the year, but the German Neuer Markt is down 39% and the French Nouveau Marché is down 45%, making it far more difficult to launch startup companies in those countries.

However, the major economies are experiencing an unprecedented global technological community linked by rapid communications. That means new ideas, like the Net, can leap across the globe, multiplying growth. But failures are multiplying globally, too. So when a dot-coms bomb, or NTT DoCoMo announces trouble with its 3G data handsets, as it did in April, the effects are felt in Europe. Here's the factor of psychology. With U.S. stock a click away on the Internet and TV sets around the clock endlessly tuned to CNBC, pessimism in any country can crop up elsewhere in a way that was never before. That may explain why a monthly Euro-commission survey of European business and consumer confidence has been steadily declining since the end of last year—well before the dot-com data registered a

The New Economy is built on global financial capital markets, and global communications. Unfortunately, the problems both ways: Links which helped growth in the boom may help cause a slump today.

He writes about the New Economy in New York.

'IF WE... START MOVING [THE WORLD] WILL FOLLOW'

Washington correspondents Rich Miller and Howard Gleckman sat down with Treasury Secretary Paul H. O'Neill on June 12 to discuss the economy, U.S. efforts to crack down on steel imports, and a dispute between the U.S. and other major nations over tax havens.

How does the U.S. economy look?

I [am] optimistic that we're going to move up the growth curve through the third and fourth quarters of this year. If we're able to start moving, [the world] will follow.

How concerned are you about the economic outlook overseas?

With Japan, I'm encouraged. I think the -0.2% real growth in the first quarter is not much of a surprise. More important, the prospects are for a change in policy. Prime Minister Junichiro Koizumi has indicated he's going to do things in a different way and fairly soon. Opening their economy to foreign



PAUL O'NEILL: *Brighter second half?*

ownership and world prices is something only they can do. We can be supportive. But this is really up to them.

What about their bad loans?

Some quibble about the amount. But it's a hell of a big number. Once they start cleaning up [those] loans, the process will have its own momen-

tum. It's like having an elephant in the room. It sounds like Koizumi not only recognizes the elephant but he's also going to get it out of the house.

A lot of the bad debts have already been marked [down] in the real world. So the dislocations [from formally writing them off] could be much smaller than people fear. The unemployment effects may not be too great.

The really important part is to make sure that, going forward, banks make viable loans to enterprises that can service capital flows on a world-competitive basis. Otherwise, they are going to have the same problem.

What about Europe?

I'm not too surprised by the slowdown. It makes our own return to higher growth important for the whole world. It's quite important for Japan to play a much stronger growth role than they have in the past 10 years. It's also important for the Europeans to work at the top end of their potential. For the whole world to grow at 3% or 3.5%, or maybe a little bit better than that, you need to have all cylinders firing.

The President has been criticized for taking the first steps toward protecting the U.S. steel industry from foreign competition. What's your response?

Look at what the President said. The critical piece was a directive to figure out a solution to the world's problem with steel. For most of the past 40 years, the industry has been in various stages of extremis. Today, [many] prices are 75% of the real cost of production. It's not just a U.S. problem.

I don't think we've got a magic solution. But the interventions that have taken place up to now have not worked very well. It's time for a new idea. My [goal] is a vibrant steel industry that has no subsidies and no protection anywhere in the world.

Other industrialized nations want to curb tax havens. You're backing away from that initiative. Why?

We have two principles. We will do everything to collect every dollar owed under our tax laws by working in cooperation with other countries. And we will not interfere in other people's tax systems. We want all the information that's necessary to ensure that our tax laws are fully enforced. Period.

COMMENTARY

By Mike France

EUROPE: A DIFFERENT TAKE ON ANTITRUST

The *History of European Antitrust Law* would make a pretty slim book. Problems such as price-fixing were all but ignored on the other side of the Atlantic until the 1980s. What's more, Europeans have traditionally allowed America to take the lead in reviewing mergers involving big multinationals.

But that's changing. The European Commission has created a unified market. To make sure it works, in recent years the Commission has attacked lazy national monopolies, instituted new rules to ensure a level playing field, and, most important to acquisitive U.S. outfits, applied antitrust law more aggressively than ever. The latest to face the new reality is General Electric Co. Chairman John F. Welch, who has struggled to save his merger with Honeywell International Inc. despite European objections.

TWIN AIMS. What is Brussels up to? Many Americans are quick to complain that the European Union is simply defending local champions. There's good reason to entertain such suspicions. France, Germany, and Spain have spent billions subsidizing their aerospace industries. The GE deal has been also heartily attacked by European rivals ranging from Rolls-Royce and Lufthansa to French avionics manufacturer Thales. "Basically, what they're saying is: [GE] is going to be a strong competitor, and that's bad," says John E. Scribner, an antitrust partner at Clifford Chance LLP, the Washington, D.C., law firm representing GE in the EU hearings..

But whatever the outcome of the GE deal, there's more going on than mere European protectionism—and it will have big implications for future mergers. Although the EU imported much of its antitrust law from the U.S., the doctrine has evolved in different ways. In America, antitrust aims to protect consumers. Across

the Atlantic, the main goal is guaranteeing the fairness of the unified market. That means that all companies should be able to compete on equal terms—and that the EU is just as concerned with how a deal affects rivals as consumers.

As a practical matter, it's much easier for rivals to kill a merger in Europe. "The EU doesn't believe in the U.S. view that if a competitor complains, it must be good for consumers," says Eleanor M. Fox, an antitrust professor at the New York University School of Law.

That competitor focus has also led Europeans to develop some unique

antitrust theories. One is "portfolio power." It posits that a merger enabling two companies to offer a broad portfolio of related products—as GE is hoping to do in the aerospace industry—may threaten competitors and should be blocked. In the U.S., such combinations are encouraged, on the theory that they create efficiencies that can help consumers.

OVERLAP. This isn't just a theory invented to lob at American targets. European regulators took a similar stand in the 1997 merger that created the world's No. 1 liquor giant, Diageo PLC. In that case, merging parties Grand Metropolitan and

Guinness didn't overlap in many specific beverage markets. But by bundling their portfolio of drinks from champagne to whiskey, the EU feared that Diageo would be able to pressure distributors into buying more of their products and shutting out rivals. To O.K. the deal, the EU required Diageo to sell two whiskey brands, including best-selling Dewar's, among other things. The EU believes that sometimes "the combination of the party's strength is greater than the individual

sum of their parts," says Brussels lawyer Ken Daly.

Still, the prospect of such reasoning being used to significantly alter or even torpedo a deal between two American companies is likely to lead to increased tensions with the U.S. In recent years, a host of European companies such as Daimler, Vivendi, and British Petroleum have been allowed to buy big U.S. targets. U.S. companies—not to mention the Bush Administration—are unlikely to sit quietly by in the face of a more aggressive EU. With the two already in disagreement about everything from agriculture to taxes to global warming, antitrust policy could easily become the next flash point.

With Dan Carney in Washington and William Echikson in Brussels



ATLANTIC DIVIDE

European and U.S. Antitrust Regulators Don't See Eye-to-Eye

COMPETITOR FOCUS In Europe, antitrust complaints from a company's rivals are taken more seriously. In the U.S., consumer harm is the key test.

LEGAL PRINCIPLES Concepts such as portfolio power—achieving greater market power by bundling goods and services—are more important in Europe.

REMEDIES The European Commission's Merger Task Force can nix a merger without taking a company to court.

RAW DATA



RAW MATERIALS

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TECHNOLOGY

SOS: MICROSOFT TO THE RESCUE?

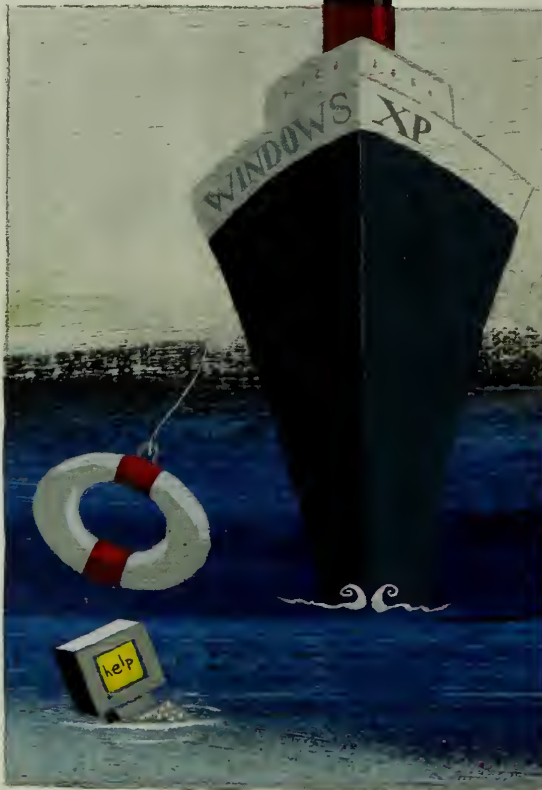
The new Windows XP may help PC sales—but only briefly

In every corner of the gray personal-computer industry, executives are awaiting a ray of hope on Oct. 25. That's the day Microsoft Corp. will launch its Windows XP operating system. With first-quarter consumer PC sales off 26% from a year ago, leaders from Hewlett-Packard Co.'s Carly Fiorina to Circuit City Stores Inc.'s W. Alan McCollough are counting on XP for a boost. Says Gateway Inc. CEO Ted Waitt: "It could be the first new compelling reason to buy a PC that we've seen in a long time."

Or will it? While XP will certainly stimulate sales, it's unlikely to provide a miracle cure for slowing PC growth. What's more, the industry's current price war means that any XP-related uptick may do little to pump up the bottom line of battered PC makers and retailers. "We can't see the light at the end of the tunnel," says Elio Levy, senior vice-president at electronics distributor Tech Data Corp.

FINITE GAINS. Undoubtedly, XP offers consumers more than any operating-system debut since Windows 95. Based on the powerful NT operating system, XP should crash far less often than prior Microsoft programs for consumers. Moreover, users who share a computer will each be able to log on to their own startup page, complete with their favorite programs and Web sites, with a single mouse click. XP also makes it far easier to store tunes and print or share digital pictures. And in what could be one of its most striking features, XP's multimedia abilities will let users talk directly to each other via their PCs—or hold video conferences with a PC camera.

Trouble is, the days when a new version of Windows could drive a consumer buying binge may be over. And XP's ad-



HIGH HOPES FOR WINDOWS XP

- It offers much simpler, higher-quality online phone calling and video conferencing
- Built-in features make music storage and home-movie editing easier
- XP crashes far less than current versions of Windows

vances don't make it the must-have that Windows 95 was. Back then, most PCs were clunkers that struggled to do even simple tasks. Win95 offered huge performance gains—and helped drive PC unit sales up 173% from 1996 to 1997, says industry tracker International Data Corp. But Windows 98 hiked sales just 20%.

Now, however, most people mainly use home computers to access the Net, which doesn't much care which Windows you use. And while PC users may

not like frequent system crashes, that doesn't mean they'll fork over \$800-plus for an XP machine. "There's not the killer reason to upgrade," says Gartn Dataquest analyst Charles Smulders.

Microsoft plans to do its all to convince consumers otherwise. It will spend

\$200 million in just four months to hype XP—twice what it spent in the same period on the extravagant Win95 launch. The software giant is coordinating an industrywide push as well. At Mar. 22 Seattle powwow, Chairman William H. Gates III and Intel Corp. CEO Craig R. Barrett pushed execs from PC makers and retailers to do their part. Microsoft will hold a larger marketing event in late June.

GOOD DEALS. XP, along with other factors, should help give PC sales a good, if short-lived bump in the fourth quarter and early 2002. The biggest reason may be the basic PC buying cycle. By October, consumers will be able to get much more power and faster PCs for the same price they paid several years ago. Credit Suisse First Boston Co. analyst Kevin A. McCarthy expects fourth-quarter PC sales to rise 4% over the year earlier. And starting next year, McCarthy and other analysts expect companies that bought PCs before Y2K to start upgrading.

But that sales bump won't reignite PC makers' financial fortunes as long as the current price war continues. With Dell Computer Corp. leading a fierce charge for market share, that seems likely. So while the demand fueled by major Windows releases in the past allowed PC makers to raise prices, XP may not do much for earnings this time around. "Even if Microsoft creates some excitement, [PC makers] will just rush to grab market share," says J. Morgan Chase & Co. analyst

Daniel R. Kunstler. The bottom line: PC makers aren't careful, that hope for a ray of sunshine may be fleeting.

By Peter Burrows in San Mateo, Calif., with Jay Greene in Seattle and Andrew Park in Dallas and bureau reports

BusinessWeek online

For more on the lure of XP, go to the June 12 Daily Briefing at www.businessweek.com/today.htm

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SIEBEL

COMMENTARY

By Mark Hyman

THE NBA NO LONGER NEEDS AIR

There's nothing like an old-fashioned David and Goliath story to fire up interest in a sporting event. This year, the National Basketball Assn. has one of the best in memory. Facing off in the league's championship finals have been the Los Angeles Lakers, led by the 7-foot-1-inch behemoth Shaquille O'Neal, and the Philadelphia 76ers, whose play-making maestro is Allen Iverson, practically petite at 6 feet. It has been a heated rivalry: Each of the first three games have been decided in the final minutes of play. Throw in great play by the telegenic Laker Kobe Bryant, and there's clear evidence the NBA has a new lineup of exciting stars.

Now fast-forward to what next season could be: the saga of an (almost) 39-year-old geezer who hasn't seen game action in three years. Just as the league is finally moving beyond its post-Michael Jordan slump to develop new stars, there's talk that the former superstar, who has been busy managing a badly losing team, may try a comeback. But for all the delight of having the living legend back on the court, it may be a distraction the NBA doesn't need.

PEAK. Admittedly, Jordan was the best thing to happen to the NBA. During his 13 seasons with the Chicago Bulls, he not only collected six championships, he cranked up fan interest. By the time the Bulls won their last championship, in 1998, regular season attendance topped 17,000 per game, a level the team hasn't reached since. The Nielsen ratings for the NBA playoffs reached a peak of 18.7, and Jordan sold more branded merchandise than any player, ever.

Since Jordan's retirement in 1998, the league has lost its sparkle. Attendance has been off. Sales of shirts, caps, and other merchandise



BRYANT VS. IVERSON: Now Jordan will be a distraction

dipped from a peak of \$2.1 billion a year to just \$1 billion in 1999. And, without its superstar supreme, TV ratings during the playoffs slumped last year to a lowly 11.6.

Now, the league finally seems to be recovering from its post-Jordan hangover. Ratings are up. Fans are discovering tough new rivalries. And marketers are finding some hot representatives.

Bryant, for example, boasts deals with Adidas, Coke, and McDonald's, among others.

And when it comes to hyping the game, nobody does it like Iverson. Madison Avenue initially found it hard to swallow his wall-to-wall tattoos and tough-guy

strut, but Iverson is cleaning up his image and relating well to young fans. Five of the top-10-selling souvenir NBA jerseys this season carry his name, according to researchers Sport Scan Info.

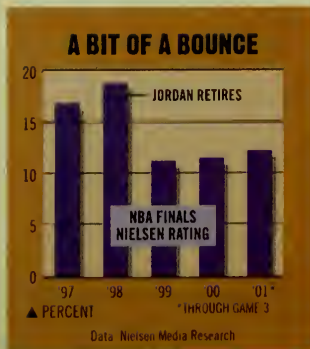
Iverson also is increasingly good for the NBA's TV ratings. During the playoffs, Philadelphia logged consistently high viewership. Game 3 of the finals drew a 16.1 rating for the NBA, 24% higher than last year and not far below the rating of Jordan's last series.

Would a Jordan comeback send Iverson, Carter, and Bryant to the showers? Hardly. But if he returns, so inevitably does the weight of the Jordan legend. "Michael coming back would shift the focus away from those players," says Robert Williams, president of Evanston (Ill.)-based Burns Sports Celebrity Service Inc., a company that arranges endorsement deals for athletes.

Nor is a comeback likely to be that good for Jordan. There's the very real question of how well—and for how many seasons—His Airness could play. Amazing as Jordan was, at 39, he'd be one of the oldest players ever in the NBA, challenged by players 15 years younger than he is. And he's not likely to get much help. As part-owner of the hapless Washington Wizards, Jordan would move to the locker room of a team with one of the league's worst records.

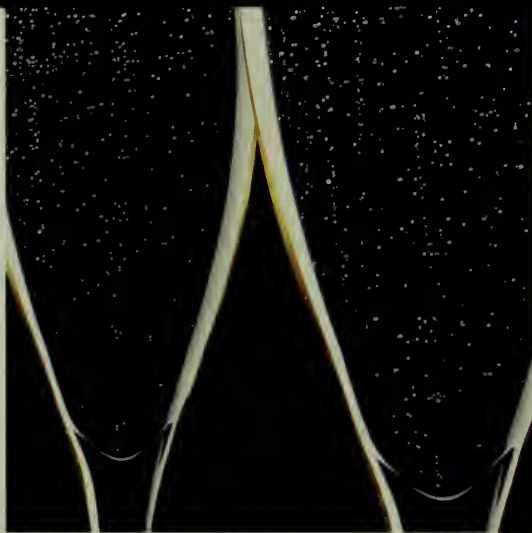
No doubt, it would be fun seeing Jordan battling today's new stars. But considering the distance the league has covered, the NBA would be better off concentrating on current stars than dragging fans down memory lane.

Hyman is contributing editor for Sports Business.



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In Business This Week

EDITED BY MONICA ROMAN

GOOD BUZZ ON A TELCO TRACKER

WORLDCOM COULDN'T HAVE picked a better time to issue its new tracking stock for its consumer long-distance business. After years of decline, long-distance prices are stabilizing—if only momentarily. The leveling out of prices has prompted some analysts to recommend buying the MCI Group tracker, which opened June 8 at \$18.01 and closed at \$24.50 five days later. The stock's \$2.40-a-year dividend doesn't hurt either. "Flat revenue growth is good enough with such a dividend," says Drake Johnstone, analyst with Davenport & Co. in Richmond, Va. But don't get too comfortable holding the MCI tracker. The long-distance unit could run into trouble again when the Baby Bells

start entering the business in earnest, which is expected by yearend.

RAIL MERGERS GET THE ALL-CLEAR

FEDERAL REGULATORS HAVE lifted their red flag on big railroad mergers after a 15-month moratorium. Still, a rush of deals isn't expected anytime soon. The reason: After a series of takeovers in the 1990s, there are only four major railways left in the U.S. In ending its merger ban, the Surface Transportation Board issued new rules aimed at averting the snags that followed many previous deals. Railroads must now give their word in writing that a merger would not disrupt service.

KRAFT, NOW IN STOCK SLICES

KRAFT'S FIRST BIG DAY ON Wall Street was as bland as a block of Velveeta. The nation's largest food company started trading June 13 on the New York Stock Exchange at \$31.50, above the offering price of \$31, and ended the day down 25¢. Kraft raised \$8.68 billion in the initial public offering, the second-largest ever after last year's AT&T Wireless Group offering. The proceeds will be used to repay Philip Morris for the December, 2000, acquisition of Nabisco. Despite the IPO, it will hardly be independent. Philip Morris, Kraft's parent, will retain 84% of the company.

RELiance: TWO OLD RAIDERS DUKE IT OUT

RELiance GROUP HOLDING'S June 12 bankruptcy filing may set the stage for a battle of the *über*-financiers. After all, the insurance company was controlled by Saul Stein-

HEADLINER: LINDA WACHNER

FROM RAG RICHES TO RAGS

WITH HER COMPANY'S JUNE 11 bankruptcy filing, Warnaco Group Chief Linda Wachner gets a break from servicing \$3.1 billion in debt and other liabilities. But many wonder if Wachner herself can survive at the helm. The famously blunt apparel exec, whose company markets such brands as Calvin Klein, Speedo, and Warner's, has overseen a collapse of the company's shares from \$44 in July, 1998, to just 39¢ now. Even though Wachner holds a 22% stake in Warnaco, her bankers currently have financial control and may not favor some-

one who led such a devastating decline. One obstacle to ousting Wachner is a severance package that could cost the company more than \$15 million to let her go. Turnaround specialist Tony Alvarez, who is Warnaco's new chief restructuring officer, dismisses speculation and notes that Wachner is leading the charge. But Peter Chapman of Bankruptcy Creditors' Service predicts "a 90% probability that there will be a new CEO." At the very least, Warnaco no longer looks like a one-woman show.

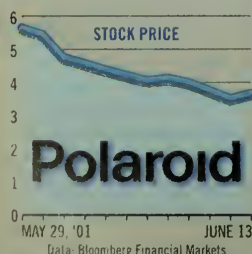
Diane Brady



CLOSING BELL

POLAROID'S PAIN

Despite unveiling new instant printing technology, Polaroid's stock has sunk nearly 40% in the past two weeks. Investors with little faith that it would help quickly were right: On June 13, Polaroid said second-quarter operating losses would be about 85¢ a share, well above the 7¢ forecast. That's why Wall Street reacted favorably when Polaroid also announced its second round of layoffs this year. The stock closed up 6%, at \$3.73.



berg, who first gained notoriety for trying to take over Chemical Bank in 1969. Although Reliance says most of its bankers and bondholders have agreed to the terms of its Chapter 11 filing, one dissenter stands out: fellow corporate raider Carl Icahn, who made runs on TWA and Texaco in the 1980s. Icahn started buying up Reliance debt in November and now controls a sizable portion of the company's bonds.

A LOWER ORBIT FOR HUGHES STOCK

HUGHES ELECTRONICS FOUND itself in the unusual position of having its stock price slip in the middle of an auction for the company. Hughes shares dropped 12%, to \$19.90, on June 12, the day after it announced that its DirecTV satellite service will have sharply lower subscriber growth this year. The bad

news comes as Rupert Murdoch's News Corp. continues to negotiate a \$40 billion merger with Hughes. Echo Star is also expected to make an offer and has lined up investment bankers Warburton and Morgan Stanley to let it some of the \$6 billion cash that General Motors wants in exchange for its 30% Hughes stake. Hughes shares traded as high as \$27.71 in February when word of Murdoch's interest first surfaced. On June 13, the stock closed at \$20.95.

ET CETERA...

- Standard & Poor's downgraded Lucent Technology debt to a "junk" rating.
- Bausch & Lomb expects second-quarter earnings to fall below expectations.
- Boeing named airline American, United, and Delta as partners for its inflight Web service.

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BRITAIN

BLAIR'S EURO DILEMMA

Can he coax Britons into the single currency?

Rod Turner runs Whale Tankers Ltd., which employs 155 people in the Midlands town of Solihull building custom truck containers to haul toxic waste. The high exchange rate of sterling, which has risen 14% against the euro since the start of last year, has turned up the heat on Whale and many other British manufacturers. Still, Turner thinks joining Europe's single currency to escape effects of the strong pound would be a mistake. "We are doing very well outside," he says. "We have the lowest taxes, lowest unemployment. Why take this leap into the unknown?"

Prime Minister Tony Blair would like to make that leap—if he thinks conditions are right. Fresh from a huge reelection win on June 7, Blair wants to go down in history as a great modernizer. And he thinks securing Britain's place in Europe is key to his legacy. He hears

from Continental leaders and pro-European advisers that unless Britain adopts the single currency, it risks becoming marginalized outside an increasingly influential European Union. Yet Blair knows he would have to spend heavy political capital to persuade skeptical Britons to join. "Blair has a real dilemma," says Ruth Lea, policy director of the Institute of Directors, a business group. "He wants to be at the heart of Europe, but he clearly can't be unless

he goes into the euro

Not surprisingly, the cautious Blair hasn't yet decided to give the euro a thumbs up. He has promised to make a decision within two years and to hold a referendum if he recommends joining. Winning such a vote is a daunting challenge. Public sentiment against adopting the euro is running at between 2-to-1 and 3-to-1. "Our guess is that Labour will not be able to shift public opinion in favor of European Monetary Union entry early enough for Blair to call a referendum in the next couple of years," says Michael Saunders, an economist at Schroder Salomon Smith Barney in London.

then, the window will have likely closed until the next parliamentary election.

What's more, the economic case for entry into the euro is not overwhelming. The euro's advocates argue that the high sterling is killing manufacturing and threatening foreign investment. But Britain's economic circumstances do not help them. Over the past five years Britain has averaged 2.8% economic growth, vs. 1.8% for Germany. British unemployment, at 3.1%, is the envy of Europe. And Britain leads Continental rivals in attracting foreign investment. There is also no evidence that being outside the euro zone has damaged the City of London. Having a corner on the market for sterling products may have given City financiers an edge to bring them into other markets.

While some British economists think Britain could adopt the euro with major disruption, others disagree. David Hillier and Adam Law, economists at Barclays Capital Inc., the investment

BRITAIN AND THE EURO

THE PROS

CURRENCY MAYHEM The volatile exchange rate makes it impossible for businesses to plan and could threaten foreign investment

POLITICAL FALLOUT The longer Britain stays outside, the more it could be marginalized in Europe

STRONGER EURO Joining the single currency would bolster the shaky euro project, whose success is in British interests

THE CONS

WHY TAKE THE RISK? Britain is way ahead of Europe on structural reform, while Europe is still in the throes of change

LOSS OF CONTROL The Bank of England is proving good custodian of sterling, while the European Central Bank is still suffering severe growing pains

DISTRACTION A euro battle would draw attention away from concerns such as fixing public services

anking unit of London's Barclays Bank, gue in a recent report that "the U.K. annot] live comfortably with euro interest rates," which are set by the European Central Bank. For example, llier says that if today's euro zone interest rates of 4.5% were applied to Britain, inflation, now about 2.4%, would up by up to one percentage point. ur economy responds differently to anges in interest rates," he says. itain's more flexible labor and goods rkets, and the higher percentage of justable-rate loans taken out, make economy more sensitive to rate anges than those on the Continent.

EPTICS. Blair will be closely following e bitter battle for public opinion. The euro campaign called Britain in Europe has enlisted such heavyweights as ilver PLC Chairman Niall FitzGerald and British Airways PLC Chairman Col-Marshall. These chieftains are getting more vocal on the euro. "A lot of itationals have been giving the government the benefit of the doubt; if they e preparation they will move investment elsewhere," says Chris Hask-chairman of Northern Foods PLC, a ll wholesaler.

The anti-euro camp, known as Business for Sterling, is less heavy on Establishment stars, but it is strong among ple in small and midsize businesses. d some well-regarded young chief cutives have been attracted to the " camp. One is Simon Wolfson, the year-old chief executive designate of hing retailer NEXT PLC. "It is not sible to effectively manage the whole nomy of Europe," he says. "Certain ions of Europe will require higher rest rates to control inflation, while ers will require lower." Europe's current performance—with low growth in many and inflation heating up in Ireland—reflects that, he adds.

ould Blair determine that the ens are right to push on the euro, a ly referendum date would be the of 2002. But Blair will have plenty ersuading to do—first of all with wn, who is more skeptical about the o than Blair. Then Blair would have negotiate favorable terms of entry Britain. Most analysts say sterling d have to come down at least 10% n its present level—one reason the ency has plunged recently.

Blair would also have to persuade Europeans to be accommodating about er details for Britain's entry. While cians are unpredictable, there's a d chance the Europeans would ge. Their own experiment with the e might be a better bet with pesky ling finessed. But Blair has some f-ing of his own to do first.

By Stanley Reed in London

FINLAND

SURPRISE! NOKIA DOESN'T WALK ON WATER

Its about-face on growth will harm its credibility

A year ago, the vision looked so alluring. As Europeans surfed the Web via their mobile phones, a new generation of speedy, data-friendly handsets would fly off store shelves. No one embraced this idea more enthusiastically than Jorma Ollila, chief of Finland's Nokia, the world's largest and most profitable mobile-phone maker.

Then, on June 12, the company stunned the investor with a profits warning, slashing second-quarter sales growth estimates in half, to 10%. The sell orders that followed wiped more than \$31 billion off Nokia's market cap in one day. The suddenly gloomy Ollila blamed a deterioration "driven by economic uncertainty, the ongoing technology transition, and less aggressive marketing by the operators."

Translation: Europe's economy is in worse shape than expected, and mobile data transmission, the big hope of companies like Nokia and its next-door rival, Sweden's Ericsson, has so far proved a dud. The networks to provide all the promised gee-whiz services won't be up and running until this summer at the earliest. The phones aren't coming soon. And in Europe, just about everybody who wants an ordinary cell phone has one.

OUCH! Until Ollila's announcement, stock-pickers assumed Nokia would somehow defy gravity, despite the woes of rivals such as Ericsson and Motorola Inc. Until recently, Nokia predicted a global market of 550 million cell phones by yearend, with the Finnish company selling 40% of the haul. Now Nokia pegs demand at 405 million phones. Analysts at Merrill Lynch & Co. reckon it will be more like 390 million.

Nokia says its earlier optimism reflected only what it was seeing in the first quarter and that it didn't expect America's problems to spread so quickly to Europe. Still, the volte-face is "a blow to Nokia's credibility" says Mark Davies Jones, managing director for telecom equipment research at Schroder Salomon Smith



OLLILA: Seduced by the mobile Net?

Barney in London. Delays from Nokia are contributing to the mobile-Net malaise. The company's phones for the next stage, so-called 2.5G, are late. Analysts see a decline in Nokia profits of 12% this year, to around \$4.3 billion on sales of \$26 billion.

Adding to the pressure, many European cell-phone operators struggling under massive debts are slashing the subsidies that supercharged handset sales. Meanwhile, the drop in European demand makes Nokia more dependent on bargain-basement markets like China. Nokia had also counted on an increase in its telecom equipment business to offset any volatility in consumer handsets. Now, Nokia admits its infrastructure sales will grow only as fast as the market, a big shock to investors.

To shore up margins, Nokia is moving some production to lower-cost countries such as Mexico and China. But what it really needs to do is deliver the promised wonders of the mobile Net. Only then will this Finnish wonder regain its star status.

By Kerry Capell in London and William Echikson in Brussels, with Peter Elstrom in New York

NOKIA'S PLUNGE



INDIA

CAN RELIANCE COMPETE?

At home, it's protected. But not for long



In mid-May, the Indian government did something unusual: It decided to reverse a policy that would have helped one of the nation's most formidable business empires. It's a curious tale. Early in the year, New Delhi had announced that, for a nominal fee, fixed-line phone operators would be allowed to offer limited mobile services without actually having to buy a mobile license. To foreign and local telecom outfits that had spent billions on such licenses, the announcement was a shock.

Industry execs soon figured out the biggest beneficiary of the policy would be Reliance Industries Ltd., a Bombay-based conglomerate with considerable political leverage. Time and again over the years, the government has altered regulations and policies in industries that Reliance has subsequently

dominated. If the January telecom rule had prevailed, the group could have undercut its rivals on price, a key advantage in a business in which Reliance is only a peripheral player. The group denies exerting improper pressure on regulators and insists the change was meant to benefit consumers. And it has vowed to forge ahead anyway with its plans to offer cheap mobile service across India.



AMBANI: The founder

BOMBAY BROTHERS

Anil and Mukesh present themselves as defenders of the Indian consumer

Still, the government's reversal must have been a wake-up call for a group that has been getting its way since a textile trader named Dhirubhai H. Ambani founded it in 1966. Over the years, Ambani and his sons, Anil, 41, and Mukesh, 44, have sold themselves to sympathetic officials as defenders of the Indian consumer—a gambit that has paid off handsomely. In the early 1990s, Reliance told New Delhi that the group could help reduce what the nation spends each year on refined oil imports if it built its own refinery. The government provided Reliance with incentives to build one in 1993, and India's purchases of refined oil supplies did indeed decline. In its telecom bid, Reliance promised to offer wireless calls for less than a quarter of the going rate.

"IN THE PAST." The Ambanis have come in for a fair amount of criticism, however. Their close ties with officials rankle rivals—though there is a long tradition of such relationships in India. Besides, insists the group's joint managing director, Anil Ambani, Reliance is a model corporate citizen. "Political linkages and controversy," he told *BusinessWeek* in March, "are all in the past. There is no substitute for performance (Reliance subsequently refused to operate for this story.) Still, the Ambanis' putative power to shape a nation's destiny has taken on almost mythic dimensions. When Reliance goes head-

AN INDIAN GIANT: RELIANCE INDUSTRIES

THE BUSINESS India's biggest private producer of textiles and refined oil products. Sales almost \$13 billion. Stock has returned 27% on average over the past five years.

THE FAMILY Patriarch Dhirubhai Ambani founded the company in 1966. His sons, Anil and Mukesh, now run Reliance day-to-day.

THE FUTURE The Ambanis want to dominate India's telecom industry by investing heavily in fiber-optics and offering cheap mobile service.

THE CHALLENGE Taking on entrenched foreign telecom giants like AT&T, SingTel, and Hutchison.

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head with another company, the rival is almost invariably vanquished.

Yet the Ambanis also get high marks for their entrepreneurial grit and savvy use of capital markets. Nobody has built a major company in India as fast as this family. In less than 40 years, Reliance has grown so big that its production of oil products and petrochemicals accounts for 3% of India's GDP. The group is consistently profitable; last year, it earned \$900 million on revenues of \$12.9 billion, up 10% over 1999. Reliance is a favorite of Indian and overseas investors, while its creditors applaud its fiscal management.

What's not clear, however, is if Reliance knows how to compete against the world's best companies. It operates in a transitional India, where tariffs as high as 41% still protect some of its operations and tax breaks go straight to the bottom line. Many of its rivals are

inefficient state companies. And Reliance's main market is its home market. Hence, Reliance faces a major test with its foray into telecom, where the likes of AT&T, Hutchison Whampoa, and Singapore Telecom already are active.

Reliance faces pressure on other fronts. Profit growth in its petrochemical business slowed last quarter amid slackening demand and expectations of a supply glut. In April, Raashid Alvi, a member of parliament, produced a 1,600-page report alleging that in 1993 Reliance diverted at least \$230 million from its public oil company into private companies

controlled by the Ambanis. They deny it.

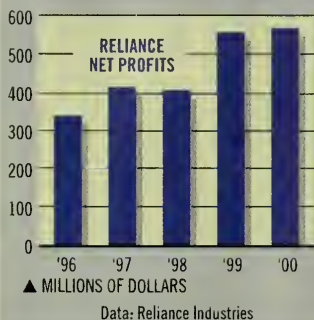
In a sign that all may not be well, the group's share price has softened in recent weeks. And in May, Reliance postponed a listing of its subsidiary Reliance Petroleum Ltd. on the NYSE, saying it would instead divest 14% of its stake in the oil producer, worth \$750 million, on

the Luxembourg exchange, where listing rules are less stringent. "Reliance has always benchmarked itself globally," says R. Ravimohan, managing director of rating agency Credit Rating Information Services of India, which rates Reliance Industries as AAA. "But the real risks lie going forward—when it comes face-to-face with competition."

A few years ago, Reliance seemed untouchable—thanks mostly to its founder. A teacher's son who grew up in western Gujarat state, Dhirubhai Ambani burned to take on India's industrial dynasties, which had carved out monopolies with licenses bestowed on them by the state. In the early days, Ambani lacked the clout to extract cheap government loans being doled out to better-connected businessmen. So in October, 1977, he issued 2.8 million shares in Reliance Textile Industries, raising \$1.8 million—one of the largest public issues in India at the time.

It was a turning point. Realizing that stock placements were the key to expansion, Ambani made sure investors were well-rewarded. And he still does. Over the past five years, Reliance investors have earned an average annual return of 27.5%. "At a time when oth-

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dian companies were ripping off areholders," says Ajay Sondhi, country head for UBS Warburg in Bombay. Ambani figured out that if he made areholders happy, they'd give him ore money."

Ambani senior, 69, and his sons are day a formidable troika. The father mains the controlling patriarch and ident genius. He focuses on long-m plans, and his sons execute them. anford University-educated Mukesh the quiet, clever strategist; even ris admit he is a "world-class" busi-ssman. Flamboyant Anil, a Wharton duate, is the group's public face. The others are often spied after midnight ling in their office in Nariman Point, mbay's financial district, not far from air palatial home.

ANY A CALL. Much of their time is w taken with telecom. Reliance is nding \$5 billion to build a 37,000-mile r-optic backbone through India and es to dominate domestic and global a and voice traffic. "We want to be a rier's carrier," Anil says. He dismiss- the recent controversy: "How can i contest the idea [that] a phone call cost 75% less for ordinary Indians?" Analysts say Reliance will find the ecom business hard going. For rters, its budget calling plan won't without government subsidies or



artificially high long-distance rates. Other telecom players won't agree to that without demanding similar advantages. More important, Indians may not want to pay for such services as broadband and Internet data. And Reliance must do well against foreign rivals with deep pockets and local expertise.

IN BANGALORE

Reliance is spending \$5 billion to lay 37,000 miles of fiber-optic cable

Reliance insists it has done its homework and will pull in some \$5 billion a year in revenues by decade's end in the Indian telecom market. Clearly, the company has staying power. It generates \$1.4 billion in cash a year, which it's willing to spend to learn the business. "Reliance should be one of the leading players, given its finances and execution ability," says Sanjeev Prasad of Kotak Securities in Bombay.

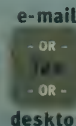
It's testing time for Reliance. The giant started as the iconoclast of India's socialist economy, an upstart that mastered the system to break the back of India's industrial empires. Now, as India joins the global economy, Reliance wants to be there, too. To succeed, it will have to adopt new strategies. If Reliance pulls it off, the Ambanis may at last reap the one thing that has eluded them: universal respect.

By Manjeet Kripalani in Bombay

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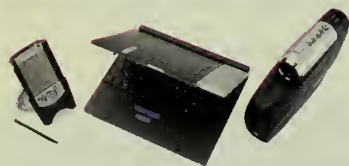


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EDITED BY ROSE BRADY

SUDDENLY, BEIJING IS BETTING ON PRAGMATISM

Beijing has prompted some head-scratching among China-watchers recently. First, the leadership toned down its usually shrill rhetoric even as the Bush Administration was talking increasingly tough on China, and Taiwan President Chen Shui-bian embarked on high-profile stopovers in the U.S. Then came another surprise on June 8. After months of backsliding in negotiations on its terms for entry to the World Trade Organization, Beijing made last-minute concessions to U.S. negotiators, winning their support in its bid to join the international body.

A new pragmatism seems to be taking hold among China's leaders. It is becoming increasingly clear that they have decided that now more than ever, the fate of their economic reforms, stability, and their own political futures is tied to continued engagement with the outside world and the investment that brings. Following the U.S. spy-plane incident, when hard-line approach to the Bush Administration was momentarily ascendant, top Chinese leaders seem determined to grit their teeth and avoid friction with the West as they pursue long-term reform goals. "They've decided to keep their heads down," says a Western diplomat in Beijing. "They want to develop their economy and focus on internal problems so eventually China can take its place in the sun."

COUNTRYSIDE WOES. Beijing also hopes this pragmatism will help it win the right to hold the 2008 Olympics and pave the way for visits by foreign leaders, including Bush, for an Asia-Pacific Economic Cooperation summit in October. But there are also domestic issues behind the restraint. These include a looming crisis in the countryside, troubled reforms, and succession changes coming at next year's 16th Party Congress. "The problems are too serious to ignore. [And] Zhu has not been able to find new solutions," says an editor with an influential Beijing policy journal.

The Communist Party's recent publication of a 308-page book, entitled *2000-2001 China Investigation Report: Research Into Contradictions Among the People Under New Conditions* underscores just how seriously the leadership is taking domestic problems. The book warns frankly of growing protests by farmers and laid-off workers as China gears up to enter the WTO. It seems intended to put party members on notice about tough times ahead—and serves as a warning that China must not jeopardize the \$40 billion in foreign investment it gets each year.

Similarly, Premier Zhu Rongji's speech on June 7 was notable for its pessimistic assessment of China's situation. Western analysts were surprised at the Premier's statement that China will have to wait until it is stronger to defend its national interests more aggressively. That was seen as an attempt by Zhu to protect himself and the rest of the leadership against accusations of being too soft with the West. Zhu also stressed the need to slow reforms—apparently an effort to win more leniency from trading partners as China adjusts to meet WTO requirements.

It's hard to say how far Beijing's leaders will push their newly pragmatic approach. China continues to jail domestic political opponents and alleged spies and crack down on religious groups. The hope in the West would be that Beijing would gradually become more cooperative on issues such as the environment, arms proliferation, or even human rights. At next year's Party Congress, where virtually all top leaders will be replaced, Jiang and Zhu are expected to push for reform-minded pragmatists to follow in their footsteps. As the challenges pile up at home, China's leaders seem keenly aware they need better relations with the world at large.

By Dexter Roberts in Beijing



PREMIER ZHU: *Pessimistic*

GLOBAL WRAPUP

THREAT TO PEACE

Peace in Northern Ireland is once again in trouble following the June 7 British elections. First Minister David Trimble's Ulster Unionist Party saw its parliamentary seats drop from nine to six. Trimble could face a party leadership challenge soon. The Democratic Unionist Party, a Protestant group opposed to the peace process, picked up 10 seats. So did Sinn Féin, which is linked to the Irish Republican Army. With his conciliatory approach under fire, Trimble is hardening his position—

threatening to resign on July 1 unless the IRA convincingly disarms. Trimble's departure could well scupper the regional government, possibly forcing London to reimpose direct rule.

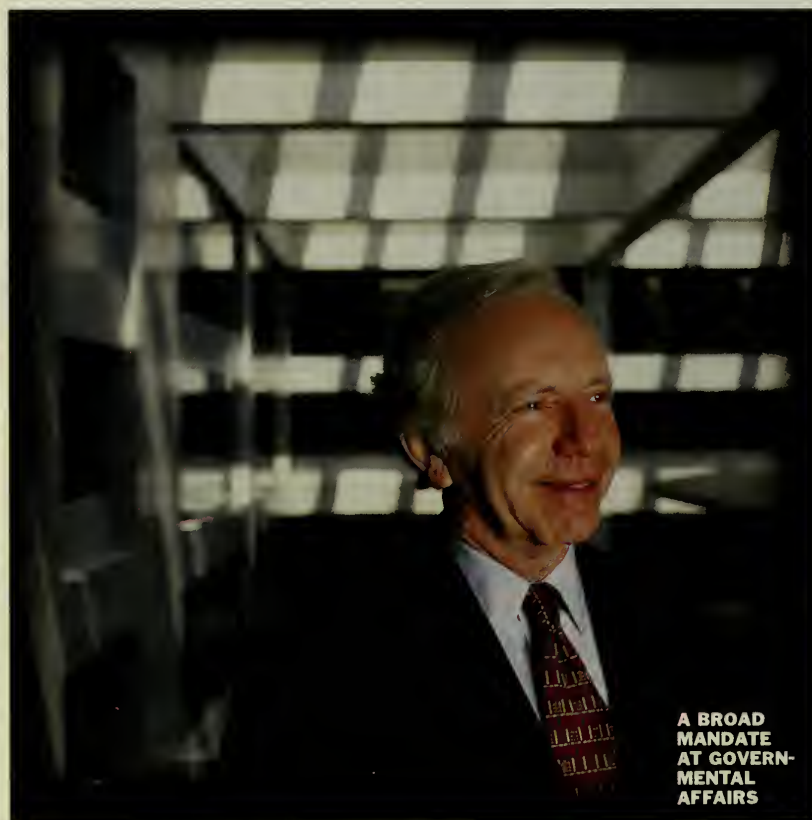
LEFTWARD TURN IN BERLIN?

► Almost 12 years after the fall of the Berlin Wall, the successor party to East Germany's communists looks set to regain a share of power in Germany's capital. Chancellor Gerhard Schröder may have little choice but to allow his Social Democratic Party (SPD) to form a coalition with the Party of Democratic So-

cialism (PDS) following municipal elections this fall. Polls show that the PDS, a reincarnation of East Germany's Socialist Unity Party, may well emerge as the No. 3 in the city, still home to former communist functionaries. Up to now, the PDS has been kept out of power by a "grand coalition" of the center-right Christian Democratic Union and SPD. But that alliance, led by Christian Democratic Mayor Eberhard Diepgen, fell apart in June in a dispute over the near-collapse of city-controlled Bankgesellschaft Berlin. Losing power in Berlin is another blow to the troubled CDU.

JOE LIEBERMAN'S NEW LAUNCHING PAD

From his high-profile committee, he can lob bombs at Bush—and redefine himself



**A BROAD
MANDATE
AT GOVERN-
MENTAL
AFFAIRS**

In a speech last March in Washington, Senator Joseph I. Lieberman delivered such an impassioned argument for giving religion a greater role in society that one member of the audience could hardly contain himself. John J. DiIulio Jr., the Bush appointee who heads the White House Office of Faith Based & Community Initiatives, jumped to his feet and yelled: "Joe Lieberman for President!"

DiIulio's enthusiasm isn't matched by the rest of the Administration, of course—especially since the Democratic senator from Connecticut seems intent on positioning himself for a possible White House bid in 2004. Lieberman says he

won't throw his hat into the ring unless his former running mate Al Gore declines to seek the Presidency again. But the senator recently set up a new fundraising committee and has been crisscrossing the country on behalf of Democratic candidates. "I'm not jumping through any doors," he says. "But I'm not closing them, either."

Artfully put. But the key question

**Why did
you vote
against
Bush's
tax cut?**

“I'm really worried this tax bill we passed will undercut our ability to keep the prosperity going. It's too big—beyond what we can afford. It doesn't offer business incentives for investment.”

for corporate lobbyists, who remember Just Plain Joe as a pro-business advocate dedicated to advancing the New Economy and safeguarding the interests of insurance and pharmaceutical companies, is this: Will he shed some of his moderation now in a drive to appeal to Democratic interest groups?

So far, the evidence is that Lieberman will try to have it both ways. He will continue to deliver his moral sermons and back some business-friendly items—while adopting elements of Gore's big-stick populism to batter Bush. Whether he emerges from this process as the New Democrat he once was remains an open question.

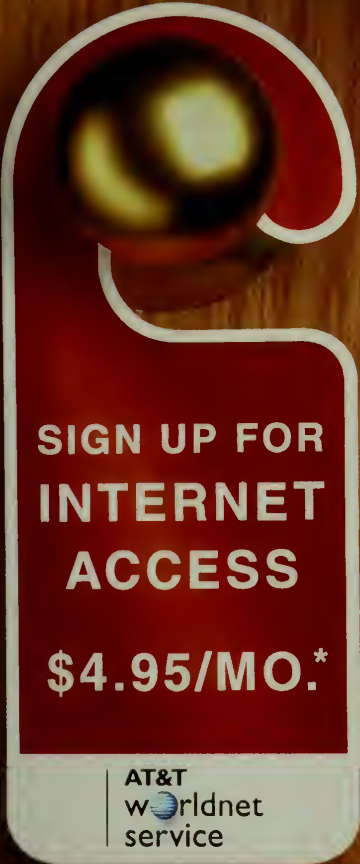
The Senate's recent switch to Democratic control could prove particularly fortuitous for Lieberman. As the new chairman of the Governmental Affairs Committee, he can convene hearing issue subpoenas, and grab the spotlight on virtually any topic. Not surprisingly, his initial targets are Bush's political vulnerabilities.

"WE'RE IN A CRISIS." First up is an investigation into why the Bush-backed Federal Energy Regulatory Commission (page 58) has been slow to ease California's energy distress by adopting temporary price caps on wholesale electricity. While interfering in the market is hardly in sync with Lieberman's New Democratic philosophy, he is not co-sponsoring a bill to do just that in the West. "In most cases I am skeptical if not negative, about price caps," says. "But not in this case. It's not a true market, and we're in a crisis."

He also plans a probe of whether Administration officials overstepped the bounds in rolling back a spate of Clinton-era environmental regulations. Down the

road, there may be hearings on voter reform and consumer-protection issues such as radiation hazards from cell phones.

In the past, Lieberman has championed free trade, product-liability reform, and cuts in capital-gains taxes. In an interview w



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BusinessWeek, the senator said he still holds those positions. Corporate lobbyists, however, point out that his current agenda at Governmental Affairs hardly jibes with the priorities of the business community. Now, "he says he wants to conduct oversight hearings with utility and gas producers?" says Dan Danner, chief lobbyist for the National Federation of Independent Business.

Lieberman insists that his instincts remain in the fiscally conservative, socially moderate zone of the Democratic spectrum. "I've gone forward on the same course I've been on for a long time," he says, adding that he never changed his position on issues such as school vouchers, about which he and Gore parted company. Instead, he just kept quiet about their differences.

Of course, Lieberman isn't the only Senate Democrat coveting the White House. John F. Kerry of Massachusetts, John Edwards of North Carolina, Evan Bayh of Indiana, and Majority Tom Daschle of South Dakota all consider themselves Presidential timber. Still, Lieberman's chairmanship of such a high-profile committee will ensure him more attention than all but Daschle.

Can Lieberman use his new bully pulpit to woo the Democratic base while staying true to his centrist instincts? While he expresses regret for some of the populist rhetoric emanating from the Gore campaign last year, the senator still has to appeal to the minority and special-interest voting blocs that are so crucial to Democratic success. That means walking a tightrope that stretches all the way to 2004.

By Alexandra Starr in Washington

Will capital-gains taxes be cut this year?

“If we repeal some of this tax bill before it goes into effect, that money could support incentives for economic growth, including a capital-gains reduction. That would do more for economic growth than anything in the Bush tax bill.”

ENERGY

THE POWER TO SOOTHE CALIFORNIA?

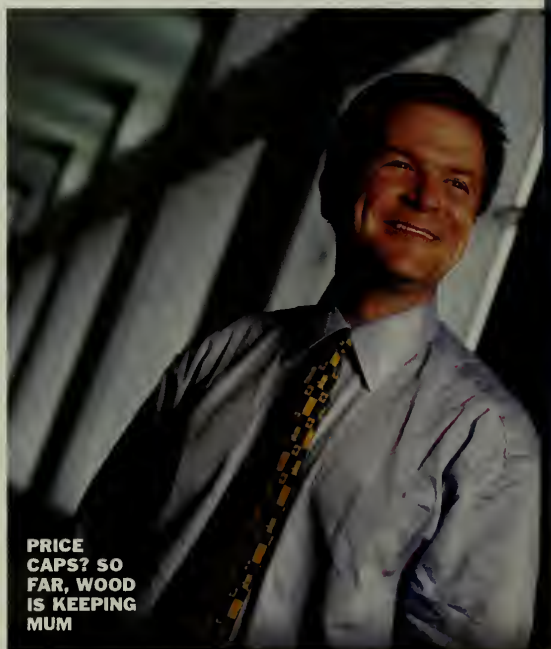
Bush picks a fence-mending pragmatist to fix the energy mess

On his final night as Texas' top utility regulator, Pat Wood III was serenaded at Scholz Garten, a beer joint near the Austin statehouse, by the staff of the Public Utility Commission. To the tune of *California Dreamin'*, they sang: "Pat will save the day...to keep blackouts away."

Apparently President Bush, who appointed Wood to the PUC in '95 and recruited him for the Federal Energy Regulatory Commission, thinks so, too. Sworn in on June 5, Wood is expected to be named chairman, supplanting conservative Curt Hebert Jr., who is closely tied to Senate Minority Leader Trent Lott.

FIRESTORM. On June 18, Wood may get his first chance to showcase his vaunted talents as a consensus-builder: At an unscheduled meeting, FERC will discuss expanding its Apr. 26 "bid cap" on electricity generators selling to California. While not the same as rigid price caps, bid caps place limits on the prices that energy suppliers can offer to municipalities and companies. Such caps are now in place in California during emergencies; FERC could put them into effect at all times and throughout the Western power grid. A similar regime in Pennsylvania has helped drive down prices.

Such a decision would help calm the political firestorm in California, where Governor Gray Davis is threatening to sue FERC over its refusal to cap power prices. Already, Bush has designated Wood—not Hebert—as his liaison to the state. Davis, who has a frosty relationship with Hebert, calls Wood "a kindred spirit." Says Ralph Cavanagh of the Natural Resources Defense Council: "FERC has had an adversarial relation-



PRICE CAPS? SO FAR, WOOD IS KEEPING MUM

ship with California, but [Wood] change the whole dynamic."

California's crisis has put the usually obscure FERC, charged with ensuring electricity rates are "just and reasonable," in the hot seat. Wood's challenge is to rise above the fray. "I'm kind of shocked at how this whole California thing has turned into a Democratic-sus-Republican issue," Wood says. "We hope we'll defuse some of that."

Wood oversaw big changes in Texas electricity and telecom markets. In 1997, when Texas' utilities were reeling from deregulation, Central Power & Light of Corpus Christi went to the PUC seeking an 8% rate hike. Wood instead ordered a rate cut of 8%. That decision endeared him to consumers and "scared the hell out of the utilities," recalls state Senator David Silvers, a Waco Republican. So far, Wood, who helped encourage the use of wind power in Texas, isn't making any promises on price caps—but neither is he using "any tool off the table."

By Laura Cohn in Washington

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COMMENTARY

By Louis Lavelle

WHAT CAMPBELL'S NEW CHIEF NEEDS TO DO NOW

On July 27, Campbell Soup Co. CEO Douglas R. Conant plans to address an audience of analysts and unveil his plan for kick-starting growth. What he almost certainly won't say is that his predecessor's plan—a combination of new products, packaging, and a massive marketing campaign—didn't work. But the results are irrefutable: While sales increased modestly, Campbell's lost market share and profits eroded. And the pressure is about to rise. Once General Mills Inc. completes its purchase of Pillsbury Co., it will rev up its vaunted marketing machine on behalf of Campbell's chief rival, Progresso.

Conant, in the job since January, is trying to avoid falling into the same trap as ex-CEO Dale F. Morrison, who resigned after failing to make good on his promise of 8% to 10% sales growth. Conant has impressed analysts with his candor, acknowledging the need for a "transformation" at Campbell and vowing to "do whatever it takes" to win in the U.S. soup market.

But past attempts to do that have amounted to just so much tinkering. Conant needs to begin the long, hard task of fundamentally remaking the company. Slow-growing for years, Campbell has resisted change and missed opportunities. Its slavish devotion to condensed soup left faster-growing products lacking for research-and-development funds and marketing support. Without a major makeover, the core product appears destined for irrelevance. Says Prudential Securities analyst John M. McMillin: "You really have to ask yourself: 'Is this the next buggy whip?'"

Not if Conant learns the lessons of past mistakes, which should be studied by any manager hoping to



avoid the pitfalls of stagnation:

■ **Love your product, but not blindly.** With its focus on its cash cow, condensed soup, Campbell for years failed to appreciate the growing demand for healthier and more convenient foods. Sure, Campbell's ready-to-serve soups now feature premium ingredients and low-fat, low-sodium varieties. But those account for less than 40% of Campbell's total U.S. soup sales. And it has yet to work the same innovations into its condensed-soup business, which has fallen 21% since 1998, according to Merrill Lynch & Co.

With Campbell's economies of scale, there's nothing stopping it from upgrading ingredients. Pop-top lids, introduced on 70 varieties last year, were a good first step on the packaging front, but innovations could go further. The company should be doing everything possible to get soup into fast-food outlets, college dining halls, and oth-

er eateries. And for a company that has watched sales plummet every summer, two words: cold soup.

■ **Beggar not your innovations.** Campbell also desperately needs to start believing in the nonsoup winners right under its nose. Among them: V8 juices, Godiva chocolates, and Pace salsa, which have all had double-digit compound annual growth rates from 1995 to 2000. But at key junctures, some of those lines have been starved for attention. Fruit-and-veggie combo V8 Splash, launched in 1997 after years of development, came out of the gate strong but lost ground to rivals last year as marketing support slipped.

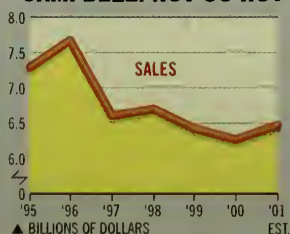
Campbell's history is one of opportunities found, then squandered. Three years ago, it considered using less heat to improve its soups' taste and texture, but backed off because retooling cost \$100 million. Progresso beat it to the punch. Says a former exec: "It's definitely a risk-averse, control-oriented culture. It's all about two things: financial control and how much they can squeeze out of a tomato."

■ **Change is inevitable—embrace it.** Exacerbating these problems is a culture overcome by inertia. Another ex-manager says, only half-jokingly, that she carried a mirror to "make sure everyone was breathing." Partly, it's the curse of size—any product change entails a massive capital investment that makes even modest improvements seem like giant risks. Thus, few good ideas are carried through to execution.

Campbell needs to reward risk-taking, remove organizational roadblocks, and summon up the courage to move bold initiatives from proposal to execution quickly and regularly. If the past has proved anything, it's that a few new products and packaging changes aren't enough. On July 27, we'll see if Conant is the mild-mannered executive he appears to be—or the revolution-ary he needs to be.

With Gerry Khermonch
in New York

CAMPBELL: NOT SO HOT



▲ BILLIONS OF DOLLARS
Data: J.P. Morgan Chase & Co.,
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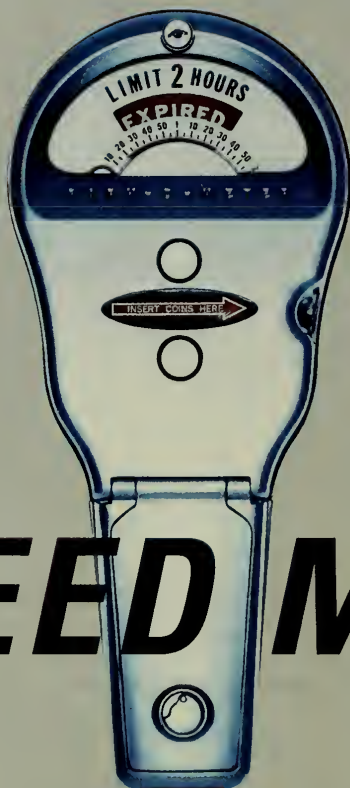
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We live in a world that is unsure of its economic future and uncertain of its technological choices, with companies needing all the help they can get. Over the past year, they turned to design not only to help define overall corporate strategy but also to act as product way-finders, matching what they sell to very specific consumer needs. In good economic times, industrial design highlights all the possibilities. In rough times, it focuses resources, drills down deep into consumer wants, and provides solutions—including a bit of fun.



The Industrial Design Excellence Awards (IDEAs) are given by the Industrial Designers Society of America and sponsored by BusinessWeek. The IDEAs for 2001 reflect a cautious restraint. This year, crazy shapes, feature-packed techno-boxes, and wild colors are conspicuously absent among the winners. Instead, a design humanism prevailed, with designers striving to place products within people's lives rather than cram cold technology down their throats, to improve on old favorite objects rather than replace them.

DESIGNS OF THE YEAR WINNERS 2001



and to refer to the past as well as the future. Winners emphasized simplicity over complexity and permanence over obsolescence. An ergonomic rope cleat for sailing, a stackable CD storage case, a hot new laptop, an improved kayak steering rudder, and an easier-to-use mouse were all existing products enhanced by redesign.

In terms of aesthetics, the retro look made a strong appearance with the gold-winning PT Cruiser and the Audrey information appliance. But retro doesn't domi-

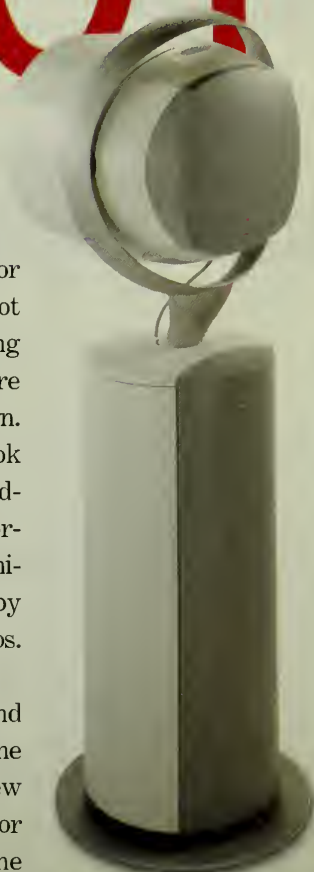
te. It co-exists with the blobby, plastic, translucent shapes epitomized by the iMac computers as well as the very edgy look of IBM Thinkpad laptops. Even the gold-winning Apple G4 titanium laptop is angular.

Awards also went to a number of firms offering design research and strategy to large corporate clients. IDEO, which received an astonishing nine AIA awards this year, won a gold for its research and work on the new Amtrak Acela Express train. IDEO realized that it wouldn't be enough for Amtrak just to build a better train. The customer experience aboard the

GOLD

★ SMARTTRACK KAYAK CONTROL SYSTEM

DESIGNER
*Manatee Design for
Cascade Designs*



SILVER

★ TERABEAM OPTICAL TRANSCEIVER

DESIGNERS
TEAGUE and Terabeam

Annual Design Awards

high-speed Acela had to compete with flying, as it whizzes along the Boston-New York-Washington shuttle route. Other big design firms, such as ZIBA Design, Pentagram Design, Lunar Design, frog design, Herbst Lazar Bell, and Fitch, also won, as did dozens of smaller ones.

There were a record 1,260 entries from around the world, including South Korea, Germany, France, Japan, Italy, Britain, Canada, Singapore, and the Netherlands. There were 44 gold winners, 63 silvers, and 82 bronzes.

In contrast with recent years when new, high-tech devices garnered nearly all of the top awards, 2001 saw an unusual number of winners among decidedly low-tech products. Check out the following pages to see incredible work tools, tractors, boats, cars, broadband devices, cameras, and PDAs. For a complete list of all the winners and their designers, turn to businessweek.com.

BusinessWeek online

For all the winners, go to the June 25 issue online at www.businessweek.com.

WINNERS FOR 2001...

Here are many of the top winners of the Industrial Design Excellence Awards:

DESIGN FIRMS	AWARDS			
	GOLD	SILVER	BRONZE	TOTAL
IDEO	2	4	3	9
PENTAGRAM	1	2	4	7
ZIBA	4	1	1	6
LUNAR DESIGN		3	2	5
FROG DESIGN	2	1	1	4
HERBST LAZAR BELL	2	2		4
FUSEPROJECT		1	2	3
ION DESIGN	1		2	3
RALPH APPELBAUM	2		1	3
BOLT	2			2

CORPORATIONS

IBM	1	3	1	5
MICROSOFT	2	1	1	4
NIKE	1	2	1	4
APPLE	1		2	3
DAIMLERCHRYSLER	2		1	3
EMERSON TOOL		2	1	3
FEDEX	3			3
SAMSUNG			3	3
UBI SOFT ENTERTAINMENT		2	1	3
AMTRAK	2			2
BOMBARDIER	1		1	2
COMPAQ	1	1		2
HEWLETT-PACKARD	1		1	2
INGERSOLL-RAND	1	1		2
MOTOROLA	1		1	2
VIRGIN ATLANTIC	1	1		2

...AND OVER FIVE YEARS

Year after year, some design firms and corporations win:

DESIGN FIRMS	AWARDS		
	1997-2000	2001	TOTAL
IDEO	35	9	44
ZIBA	19	6	25
PENTAGRAM	14	7	21
FROG DESIGN	16	4	20
FITCH	15	2	17
LUNAR DESIGN	11	5	16
HERBST LAZAR BELL	11	4	15
ALTITUDE	10		10
HAUSER	9	1	10
RALPH APPELBAUM	6	3	9
SMART DESIGN	6	2	8

CORPORATIONS

APPLE	13	3	16
SAMSUNG	13	3	16
COMPAQ	11	2	13
IBM	7	5	12
BLACK & DECKER	11		11
MICROSOFT	7	4	11
PHILIPS	9	2	11
HEWLETT-PACKARD	8	2	10
STEELCASE	9	1	10
FISHER-PRICE	7	2	9
NIKE	4	4	8
SYMBOL TECHNOLOGIES	6	2	8
CROWN EQUIPMENT	7		7
DAIMLERCHRYSLER	4	3	7
MOTOROLA	5	2	7

Data: Industrial Designers Society of America

GOLD

KARLYN CLEAT

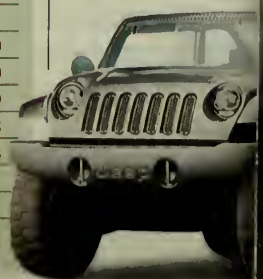
DESIGNER
Karlyn Group



GOLD

2001 JEEP WILLYS SHOW VEHICLE

DESIGNER
DaimlerChrysler



Getting There With Style to Spare

Getting around has never been such fun. A newly designed drive system on the leaf-green Deere lawn tractor allows for a zero turning radius: It gives its operator the maneuverability to turn on a dime when mowing those miles of suburban lawn on the weekend. For pure aquatic excitement, take an old-fashioned pontoon boat, reconfigure it to create a special compartment for the kids, then propel it through the water—very fast—with jet-powered engines. Bombardier's Islandia boat has a lot of space for socializing, it's stable, and it has a "head" that can accommodate someone who's as tall as 6 feet, 2

inches. For sheer emotional appeal, the PT Cruiser from Chrysler Corp. is a grabber. Its retro design from the 1940s makes for a crossover hot-rod—one that has a sensible four-cylinder price and lots of interior space. A removable shelf doubles as a tabletop for tailgate parties.

GOLD

CHRYSLER
PT CRUISER

DESIGNER
DaimlerChrysler



OLD

BOMBARDIER ISLANDIA BOAT

SIGNER
Bombardier, Canada



OLD

JOHN DEERE SPIN-STEER
TECHNOLOGY LAWN
TRACTOR

SIGNER
Henry Dreyfuss Associates
for John Deere



IBM

Big Blue Takes Home A Big Five

IBM won five awards in 2001, more than any other corporation. With the Netvista X40i, Big Blue radically redesigned the PC, hiding drives, circuit boards, and accessory cards behind a large flat screen. Press a button, and a hidden bay containing the DVD and diskette drives descends gracefully for access. For those embarrassed to bring a laptop to a meeting, the TransNote allows you to take digital notes on a notepad. Designers joined a small laptop to a notepad with a folding hinge. The laptop senses what is being written for later editing. IBM brought unity to its wildly successful but increasingly incompatible line of ThinkPad laptops with an innovative port that lets people connect to a variety of options. It also designed a ThinkLight that illuminates the keyboard in dark places such as an airline cabins.

BRONZE

THINKPAD 2000 FAMILY

DESIGNERS
IBM Italy and
Richard Sapper, Italy

SILVER

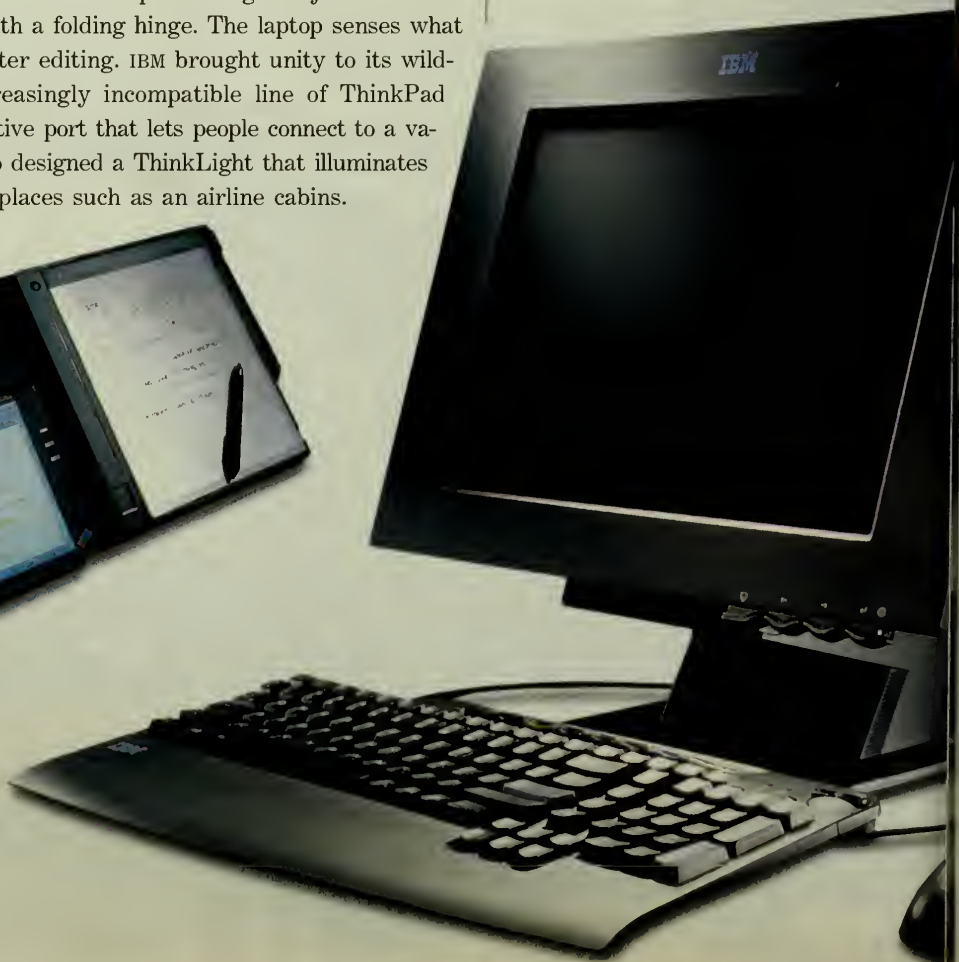
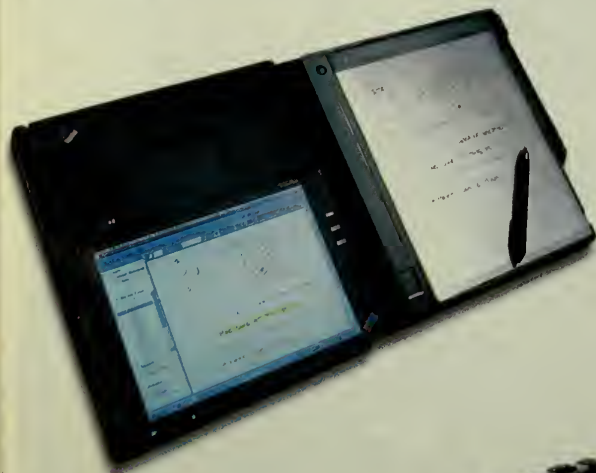
NETVISTA X40i PC

DESIGNERS
IBM Italy and Richard
Sapper, Italy

GOLD

IBM TRANSNOTE

DESIGNER
IBM U.S. and Japan



Business Casual Never Looked So Good

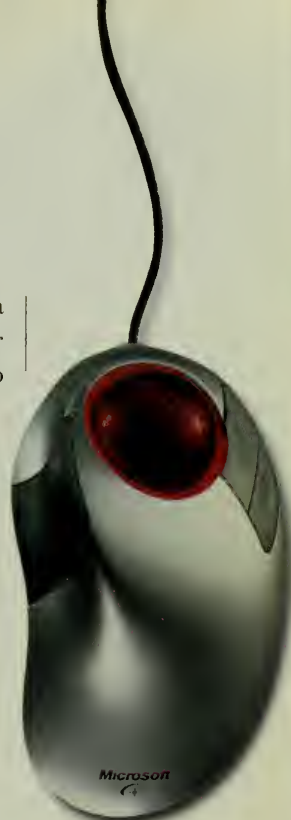
Philips' reputation for first-rate high-tech design received a boost with its ToUcam V-Mail camera. Clawlike legs hook over both pc and laptop screens, giving the colorful ToUcam video camera the appearance of a toucan bird perched on its legs. The Palm M100 has a rounder, friendlier shape than the sleek Palm V and colorful, interchangeable faceplates. PowerPoint goes vertical with the Compaq MP2800 Microportable Projector. Compaq Computer reshaped the traditional flat projector. A red LED glow reflecting its optical sensor technology, plus a metallic finish, makes Microsoft's TrackBall Explorer mouse shine.



SILVER
PALM M100
DESIGNERS
Microsoft Design & Palm



BRONZE
**TOUCAM V-MAIL
CAMERA**
DESIGNER
Philips Design



BRONZE
**MICROSOFT
TRACKBALL EXPLORER**
DESIGNERS
Microsoft and Surface
Strategy



GOLD
**COMPAQ MP2800
MICROPORTABLE
PROJECTOR**
DESIGNER
Compaq Computer

From Rail to Mail: Making The Customer Feel at Home



Research and strategy for corporate clients are playing ever bigger roles in product design. For Amtrak's first high-speed train, IDEO put together a three-pronged strategy—focusing on customer service, branding of the Acela name, and more comfortable and accessible rolling stock. To compete with air shuttles, IDEO designed a European rail-travel experience, not just a train.

Ziba's redesign of all FedEx World Service Centers focused on the interactive experience between the customer and the agent. Designers videotaped, interviewed, and role-played to understand the physical and behavioral barriers between customers and agents. They then designed a more open environment to bring them together, with modular and flexible furniture that FedEx can configure to suit its centers around the world.



GOLD

AMTRAK ACELA EXPRESS

DESIGNERS

IDEO, Nikolaus Franz
Adrian Corry, Amtrak



GOLD

FEDEX CENTER ENVIRONMENT AND FURNITURE

DESIGNER

ZIBA Design for
FedEx



SILVER
**◀ JEEP TITANIUM
 CD BOOMBOX**

DESIGNER
*Fitch for Kash 'N Gold
 Telemania*

CONSUMER TOOLS

Home Is Where The Art Is

The first Jeep boom box was retro—with analog knobs, deep yellow color, and a boxy shape. The new Jeep Titanium CD Boombox by Fitch Inc. jumps to the future with a brushed metallic finish, digital controls, and round speakers. The TDK Stack CD Case is designed by Ideo to protect just the bottom half of the CD. The design uses manufacturing materials in half, reduces the size of the case, and allows CD-maker TDK to sell more products in stores.

Emerson Tool Co.'s Ridgid RoboHammer has a thin slot in the head that connects to an oval-shaped hole filled with shock-absorbing material; hit a nail, and there's less recoil. ZIBA Design redesigned flash-memory storage into a "cool" tool. The FlashKey lets people share music files and fits into a shirt pocket.



**IDEO
 SYSTEMS FLASHKEY**

DESIGNER
*ZIBA Design for
 Emerson, Israel*



SILVER
▶ TDK STACK CD CASE

DESIGNER
*IDEO and TDK
 Electronics*

SILVER
**◀ RIDGID
 ROBOHAMMER**

DESIGNER
Emerson Tool



Exploring the Congo And the Cosmos

The design of the Congo Gorilla Forest at the Bronx Zoo puts people in the center of a gorilla habitat at eye level, breaking down the barriers between viewer and viewed. The Wildlife Conservation Society wanted to remake the very concept of "zoo," changing it from a place where people see animals behind barriers to one where they can experience the animals' own world. Helpern Architects used full-length windows to bring the two species together safely.



GOLD

ROSE CENTER FOR EARTH & SPACE

DESIGNER
*Ralph Appelbaum
Associates, for American
Museum of Natural
History*

The 1½-inch glass is thick enough to withstand a charge from a 400-pound, 6-foot male silverback gorilla. Interactive displays teach about conservation and the loss of the animals' habitat.

Information clusters, mosaics, projections, and sophisticated graphics inside the Rose Center for Earth & Space/American Museum of Natural History in New York City inspire awe and curiosity about the planet and the cosmos beyond.

SILVER

CONGO GORILLA FOREST EDUCATION CENTER

DESIGNER
*Helpern Architects,
Wildlife Conservation
Society, Jolly Miller*



A man wearing a brown leather jacket over a dark vest and a light blue shirt, with a brown cap. He is standing in a field with a wooden fence in the background.

Biotechnology
is helping him
protect the land
and preserve his
family's heritage.

"I'm raising a better soybean crop that helps me conserve the topsoil, keep my land productive and help this farm support future generations of my family."

—Rod Gangwish, farmer

Biotechnology is helping Rod Gangwish to grow a type of soybean that requires less tilling of the soil. That helps him preserve precious topsoil and produce a crop with less impact on the land. Preserving topsoil today means a thriving farm for generations to come.

Biotechnology allows farmers to choose the best combination of ways to help grow their crops. It helps cotton farmers use fewer chemicals to protect their crops against certain pests. And, it's helping provide ways for developing countries to better feed a growing population. And, in the future, it can help farmers grow better quality, more nutritious food.

Biotechnology is also enhancing lives in other ways, helping to create more effective treatments for diseases such as leukemia and diabetes.

Biotechnology is helping create solutions that are improving lives today, and solutions that could improve our world tomorrow. If you're interested in learning more, visit our Web site or call the number below for a free brochure about biotechnology and agriculture.

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Built to Travel

Dennis Carlson designs military weapons and systems. His THAAD (Theater High-Altitude Area Defense) Mobile Command Shelter Concept reworks the ongoing \$17 billion missile defense project. By bundling components into simple, modular “electric sticks,” the Army can cut the time needed to set up in the field, replace civilian technicians with onsite soldiers, and reduce costs. Carlson designed the THAAD with the user, not the technology, in mind. So did Charis Ng, a student at the Rhode Island School of Design. Pulling a cold IV pole around hospital corridors can be uncomfortable and humiliating, so Ng designed a backpack IV that patients can just carry. Samsung, one of Asia’s leaders in design, shaped its Compact Mobile Phone concept like a woman’s compact. It opens to show a large screen, good for 3G text and graphics, and a big keyboard. Calls are made with an earpiece.



BRONZE

► IV-PACK

DESIGNER
Charis Ng of
Rhode Island
School of Design



GOLD

► THAAD WORKSTATION

DESIGNER
Dennis Carlson



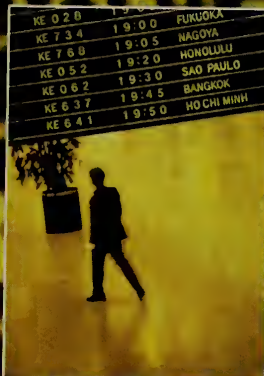
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► COMPACT MOBILE PHONE

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to overcome critical obstacles during your global expansion. And now, we can help you overcome one more: synchronizing particulars of hundreds of local tax jurisdictions with your global tax strategy. At KPMG, teams of dedicated international tax specialists, steeped in the tax laws of key regions around the globe, provide a centralized resource for country-specific insight. Working hand in hand with local members of KPMG International and your company, they make sure all of the global and local aspects of your tax strategy work as one. To find out how we can help your company operate more efficiently on the global stage, contact Jeffrey M. Stein, Vice Chairman, Tax Services, at 1-877-ASK-KPMG.

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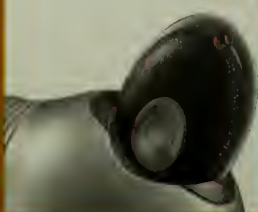


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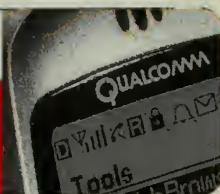
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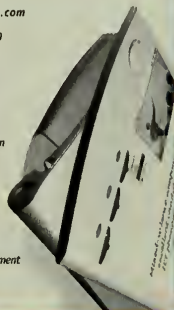
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Industrial Design Directory

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For more information on the companies in this directory, you can select from the easy options listed below.
Companies will be found in the **June 25, 2001** issue.



Internet You can request information and/or link directly to company websites through our electronic reader service program@ www.businessweek.com/BizLink in the June 25, 2001 issue.

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IDSA
www.idsa.org

This site lists a brief description of the companies in the directory, along with contact numbers and company hotlinks. It also features a Gallery of the 2001 IDEA winners, current industrial design news and resources, hotlinks to related sites and a calendar of design events.

BusinessWeek

| www.businessweek.com

Jacques A. Nasser was on top of the world. Striding the halls of the Detroit auto show in January, 1999, the freshly minted CEO of Ford Motor Co. commanded attention. Just a few days into his new job, Nasser was being hailed as the industry's newest auto baron—who might at any moment pull off a huge merger with the likes of Honda, BMW, Volvo, or Nissan. Indeed, Nasser seemed to revel in the speculation about how Ford would spend its \$23 billion cash hoard, cracking jokes about the media frenzy. Outside, enormous snowdrifts paralyzed the city. But inside, as he contemplated Ford's future, Nasser's mood couldn't have been sunnier.

Last month, Nasser, 53, once again found himself the center of attention. But this time, as he stepped in front of the cameras, the mood was starkly different. Haunted by safety concerns about the popular Ford Explorer in the wake of last year's Bridgestone/Firestone Inc. tire recall, a somber Nasser announced that Ford would replace an additional 13 million Firestone tires on its pickups and sport-utility vehicles. The cost: a staggering \$3 billion.

Nasser's latest announcement makes the Firestone debacle the biggest product recall in automotive history and he'll be back in front of Congress on June 19 to explain. But as devastating as it has been, the tire scandal is only the most public of an array of crises confronting Nasser. The company, widely regarded as the strongest and best-run U.S. auto maker, is sud-

denly on the defensive. Ford is suffering from a series of self-inflicted wounds, from embarrassing quality glitches and costly product delays to declining productivity. Those mistakes couldn't come at a worse time: The economy is slowing, and Ford's share of the U.S. truck market—its main source of profits—is dwindling.

FLOORING IT. Certainly, Ford's problems aren't all Nasser's doing. Many are the result of industry trends that have been making for years. Yet underlying many of Ford's troubles are the wrenching cultural changes mapped out by Nasser as part of his bold attempt to transform an Old Economy automanufacturer into a nimble, Net-savvy, consumer powerhouse. Nasser is driving fast—too fast, for many in the company. In his 33-year career at Ford, he has often shown quick reflexes and sharp instincts. This time, though, the stakes are higher than ever. "Would we like to do better?" he says of the company's current woes. "Of course. But we'll take our lumps. We've been through much worse and we'll come through stronger." If he's right, Jacques Nasser will go down in history as the man who brought Ford into the 21st century.

Ford

BY JOANN MULLER



tury. If he isn't, he risks becoming a management lesson in why not to remake a company.

Almost as soon as he ascended to the corner office, Nasser began overhauling Ford, unveiling one initiative after another. He signed agreements to partner with Microsoft Corp. and Yahoo! Inc. on the Web. He pushed out Ford's Old Guard and brought in talented young stars from the auto industry and beyond. He flattened Ford's bureaucracy, giving more autonomy to regional executives, and shook up senior managers by tying their bonuses to gains in customer service. Gone were the days of automatic promotions and seniority. "You've got to earn a promotion" he thundered at young execs shortly after becoming CEO. "The days of entitlement at Ford Motor Co. are over forever."

He also changed the face of Ford. He added Volvo and Land Rover. Then, convinced that Ford's commitment to consumers shouldn't end when they drive off the dealer's lot, Nasser also bought repair shops, a driving school, the Hertz rental agency—even a junkyard. For Nasser, it wasn't enough to be one of the best global auto makers. His goal was to make Ford one of the best global companies, period. He

wanted Ford—and himself—to one day be as revered as General Electric Co. and its much-admired CEO, Jack Welch.

But while Nasser has roared ahead, observers inside and outside Ford say the rest of the company hasn't always followed. As employees at all levels struggle to adapt to the host of sweeping changes Nasser has set in motion, many say Ford has lost sight of its fundamental mission: building quality vehicles as efficiently and profitably as possible. "It's all these things being

jammed down our throats," says John Wyrwas, 61, a power-

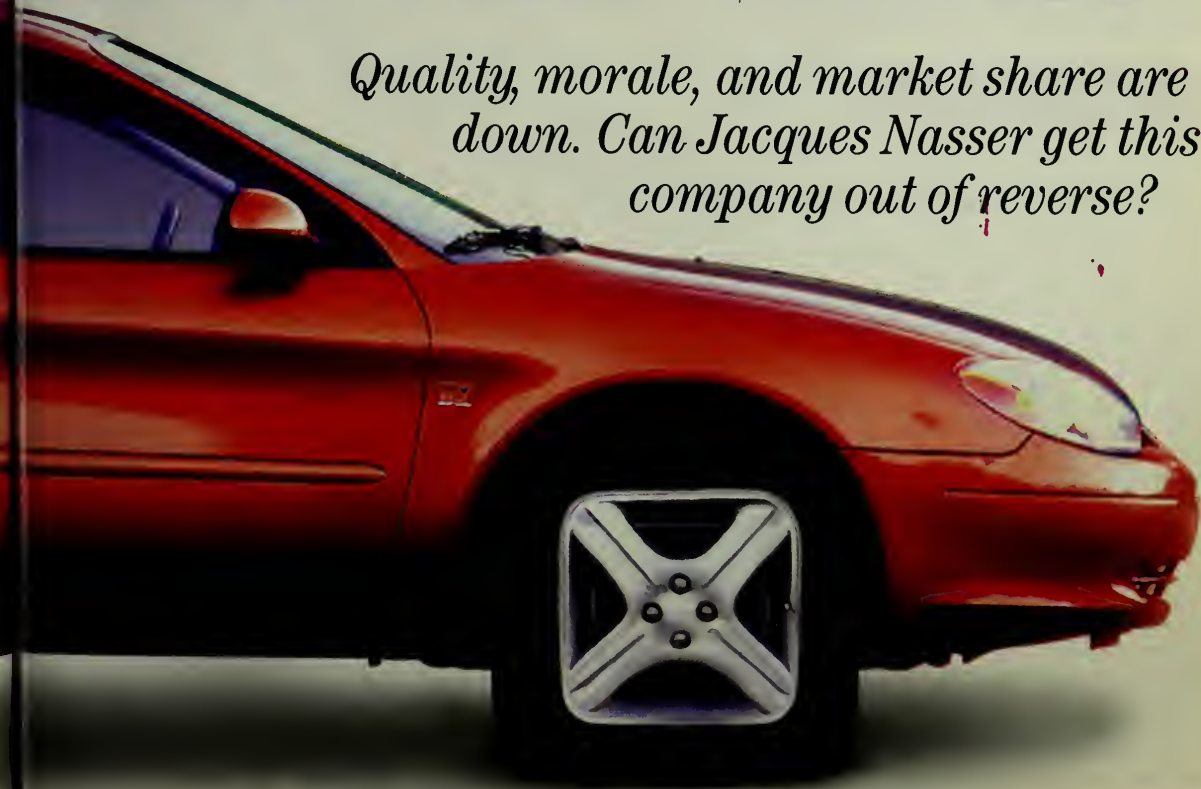
train engineer who retired this month. "When we're working on all these things, who's working on the product?" It isn't just a rhetorical question. Harbour & Associates' annual ratings of auto-factory efficiency, released June 14, showed labor productivity at Ford falling 7% in 2000, while that of its rivals rose.

Now, there's a backlash against the pace and intensity of many Nasser initiatives. A new performance-review system for Ford's 18,000 managers has met with such hostility that 42 of

Cover Story

WHY IT'S WORSE THAN YOU THINK

Quality, morale, and market share are down. Can Jacques Nasser get this company out of reverse?



BREAKDOWN *Nasser's aggressive drive to shake up Ford has the company sputtering. Here are some of the problems:*



QUALITY DECLINE

Ford now ranks last among the seven biggest carmakers in quality. Last year, recalls and delays cost it at least \$1 billion, not counting the tire recalls. The redesigned Explorer, out since February, has already been recalled twice. Now, Ford is delaying new versions of its Expedition and Lincoln Navigator for extra testing.



them, including Wyrwas, have filed two class actions, charging that the system targets older workers and white males who are stereotyped as resistant to change. Nasser preaches relentlessly about the need to get closer to the Ford customer, but he has had to rebuild his marketing team after Vice-President James C. Schroer and other marketing execs fled to Chrysler in February. Nasser imported Six Sigma, the management technique popularized by Jack Welch, as a way to teach Ford managers to root out flaws,

Cover Story

but in a ranking of quality among the seven largest carmakers this year, Ford came in last. With all the turmoil, it's no wonder Ford has given up 1.7 percentage points of market share in the first five months of the year.

As if Nasser didn't have enough problems, rumors have surfaced of a rift between him and Ford family scion William Clay Ford Jr., the company's chairman. Nasser was forced to respond publicly in early June, declaring that he has the full backing of Ford's board of directors. Those directors aren't talking, but sources close to them confirm that the CEO's job is safe. However, the board does feel that Nasser—with 16 direct reports and no clear No. 2—is overextended and needs help managing the company's operations. One rumor has Ford bringing the chairman of its European operations, Nick Scheele, back to the U.S. as president of Ford Automotive Operations (page 86). Nasser says only, "I think I've got the best team in the business. However, if we can make it even stronger for our customers and shareholders, we will."

Nasser may still have the board's support, but he has lost the goodwill of some Ford employees, the trust of many consumers, and the confidence of Wall Street. The missteps at Ford may even force him to give up one of his greatest dreams—that the company would soon overtake General Motors Corp. as the world's largest auto maker. That seemed a foregone conclusion last year. Not anymore. Says Morgan Stanley Dean Witter & Co. analyst Stephen Girskey: "It's



FIRESTONE FIASCO

Last August's recall of 6.5 million tires on the popular Explorer and Mercury Mountaineer SUVs cost Ford about \$500 million. This year Ford will take a \$2.1 billion after-tax charge to replace 13 million more Firestones. To cut it off, Explorer sales have plunged 21% this year through May.

amazing to me how fast Ford has unraveled.

In Nasser's defense, many of the problems he's grappling with result from decisions made long before he took charge. "He gets nailed with the problems, but they're what he's trying to change," says Noel Tichy, a University of Michigan professor and close adviser to Nasser. Improving quality and business productivity across a \$170 billion company takes time, argue Nasser's supporters, a initiative begun two to three years ago, are just beginning to kick in. Nasser admits that Ford's record on quality has been spotty, but he points out that there are bright spots. Its Jaguar brand, for instance, was notorious for its lousy quality 10 years ago, and now is ranked second best in the industry. But Nasser emphatically rejects the notion that he's trying to fix change too quickly on the carmaker. "If there are any greys," he says, "it's that we're not moving fast enough."

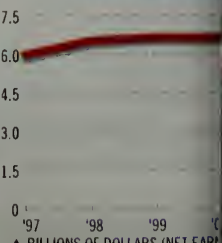
Until recently, Ford was Detroit's Golden Child. When Nasser took over, archrival GM was a basket case, steadily losing market share even as industry sales soared. Chrysler was still reeling from its 1998 takeover by Daimler-Benz. And Japanese auto makers had only begun to attack the U.S. truck market. Ford, on the other hand, was in the

FORD LAGS THE INDUSTRY IN QUALITY...

AUTO MAKER	PROBLEMS PER 100 VEHICLES
TOYOTA	115
HONDA	133
NISSAN	145
GENERAL MOTORS	146
DAIMLERCHRYSLER	154
VOLKSWAGEN	159
FORD MOTOR	162

Data: J. D. Power & Associates

...AND EARNING ARE CRASHING



Data: Deutsche Banc Alex



when industry pundits warned earlier this that Detroit was going to get clobbered economic slowdown, Ford declared itself far r-positioned than its crosstown rivals to her a slump. Even though profits in 2000 dropped by more than half to \$3.5 billion on



With so many new competitors gunning for



NASSER WANTS TO OVERTAKE GM; HIS MODEL IS GE



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THE QUALITY THING

"Quality is Job 1." That boast was once widely used in Ford's advertising. But the auto maker has recently been plagued by a spate of recalls. Ford hopes its embrace of Six Sigma will reduce defects in the future. Here are some recent recalls:



1999 MUSTANG COBRA

The engine in the SVT Mustang Cobra was unable to generate 320 horsepower, as advertised. About 4,000 were recalled, and the 2000 model year was scrapped entirely.



2000 FOCUS

This compact endured six recalls. One of them, covering 207,000 cars, concerned faulty hub nuts that could cause the wheel and brake-drum assembly to come off.



2001 ESCAPE

This new model has had five recalls since its introduction. The last covered 51,000 vehicles. Problems included defective speed-control cables, leaking fuel lines, and missing rivets on windshield parts.



2002 EXPLORER

Some 52,000 SUVs were recalled to check for gashes in the tires, which occurred on the assembly line. The government said the defect could result in tire failure and crashes.



Ford's rich truck franchise, the auto maker's margins will come under increasing assault. As rivals jack up discounts and incentives to woo buyers, Ford has been forced to match them. Both Ford and GM are spending roughly \$2,300 per vehicle to sell their large pickups and SUVs. Those incentives will further depress profits. Ford has warned analysts that even without the Firestone recall, it might not meet its 4% net-margin target for

North America this year. Deutsche Bank analyst Rod Lache sees a repeat of what

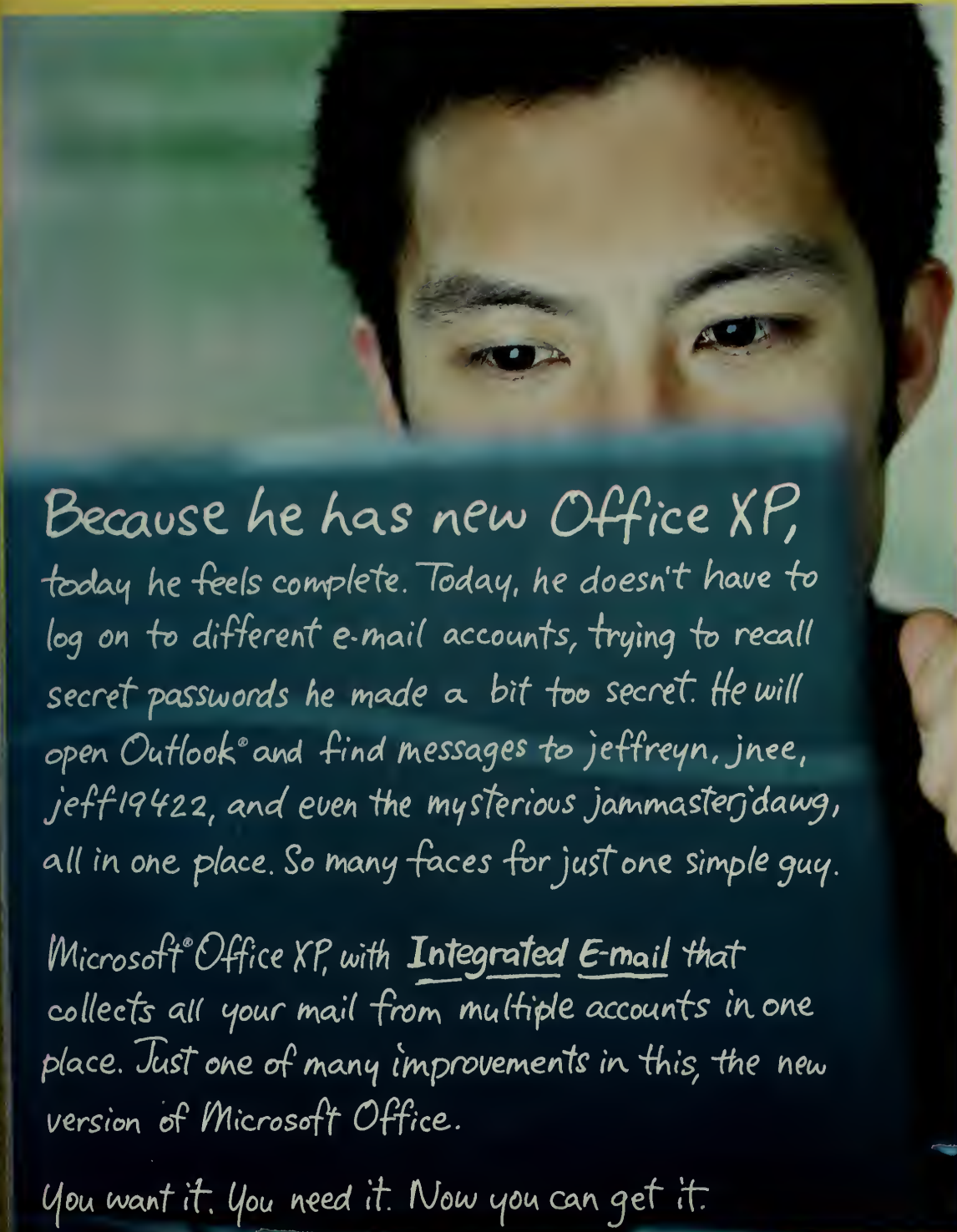
Cover Story

happened to Detroit auto makers in the car business back in the 1980s: Profits vanished amid increased competition and overcapacity. "It's very possible that trucks will be just as unprofitable as cars in three to four years," warns Lache.

The threats to Ford don't all come from the outside. After all, it's not outsiders who have caused its embarrassing quality slipups. In a recent survey by J.D. Power & Associates Inc., Ford ranked worst of the top seven global auto companies in quality. The No. 2 auto maker had 162 problems per 100 vehicles, compared with just 115 for Toyota. Such glitches led to a string of recalls. The Focus compact car, which debuted in 1999, had six recalls, and the Escape, a small SUV introduced a

year later, had five. Even the 2002 Explorer, which was closely scrutinized by Ford dealers, was recalled twice—once to fix a bracket that could allow the rear window to shatter again to check for gashes on the tires caused by Ford's own assembly line. In another humiliating blunder, Ford was forced to cancel the entire 2000 model year for its souped-up Mustang Cobra muscle car because the 1999 model's engine could generate the 320 horsepower advertised. It took the company a year to fix the problem and get the Cobra back to dealers' showrooms for 2001.

QUALITY'S COST. Shoddy vehicles have hurt Ford's bottom line in several ways. Quality problems and related production delays cost the company more than \$1 billion in lost profits last year alone, according to Nasser. Obviously, sales suffer for a vehicle that is perceived as a lemon. But lousy quality also means higher warranty costs. Deutsche Bank estimates Ford's average warranty cost per vehicle at \$650, vs. \$550 at GM and only \$400 for Toyota. That puts Ford's annual warranty cost at about \$2.6 billion. A car of mediocre quality also yields less resale time, which affects lease-payment calculations. In order to keep the payments low, the auto maker must subsidize the car's trade-in value. That helps explain why Ford's average warranty cost per vehicle is \$2,122, on a par with GM's, while Toy



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whose cars fetch more at trade-in time, is just \$1,150, according to Deutsche Bank.

Add it all up and Ford has a huge cost disadvantage compared with the Japanese. A study by Deutsche Bank concludes that Toyota has an \$1,800 per vehicle advantage over Ford because of its greater efficiency and ability to command higher

Cover Story

prices. So to match Toyota on price and remain profitable, Ford has to find a way to cut annual costs by more than the \$1 billion it had planned. As the company tightens its belt, it is also pushing back car launches. A new version of the F-Series pickup—its best-selling vehicle—has been delayed a year, while an updated Ranger pickup has been postponed indefinitely, say dealers and suppliers, allowing Ford to put off billions in capital spending.

GM has a similar cost disadvantage. But as the Harbo Report showed, GM has made big leaps in productivity, which means it's on a faster cost-cutting track than Ford. GM's productivity, as measured by the number of worker-hours needed to make a vehicle, increased 8%, while Ford's fell 7%. Ford maintains a slight edge overall, but GM has just about closed the gap. Nasser points out that Ford's productivity is excellent in plants where new lean manufacturing processes are taking root. Still, he vows improvement and says, "I take full responsibility. I don't walk away from anything."

So why can't Ford—a company that has been in the business of launching cars for nearly 100 years—get it right? Distracted by Nasser's cultural revolution, coupled with dramatic changes in how the industry operates, simply left too much room for error. Like other auto makers, Ford is pressuring suppliers to take on more of the engineering while demand-

IN EUROPE, THE NEW FORDS ARE TURNING HEADS

Spirits may be sinking in Dearborn, Mich., but the mood is cautiously upbeat these days at Ford's European headquarters in Cologne. That's no small turnaround: For six years, as Ford Motor Co. steamrolled through the U.S., its European arm steadily lost market share. Now, things are changing, thanks to a solid newcomer in Ford's lineup: the \$20,000 Mondeo sedan, introduced late last year.

European drivers have flocked to buy the Mondeo. Meanwhile, good buzz has helped boost sales of Ford's overlooked Focus, a \$15,000 compact launched in 1998. The influential *Auto Motor und Sport* named the Mondeo best in class, ahead of Volkswagen's popular Passat, while adding that the Focus handles better than General Motors Corp.'s Opel Astra. Says Nick Scheele, Ford of Europe's 57-year-old chairman: "In Europe, you have to have inspirational vehicles that people are proud to own and lust to drive."

A CORNER TURNED? As a result, the market share of Ford in Europe—not including its luxury brands Volvo, Jaguar, Aston Martin, and Land Rover—grew to 9.1% in the first four months of 2001, up from 8.6% in the same period in 2000. Sales of the popular cars have also helped stanch the flow of red ink in Europe. After losing \$1.1 billion in 2000, Ford's European operations managed a first-quarter

profit of \$88 million, on sales of \$8.7 billion.

Since becoming chairman in January, 2000, Scheele's major focus has been a \$1 billion restructuring of Ford of Europe. The early results are a big reason that many in Detroit consider him a candidate to fill the vacant job of running Ford's

the Continent are still in the future. Meanwhile, Ford is investing \$400 million to modernize its huge assembly plant in Cologne and develop fuel-efficient diesel engines with PSA Peugeot Citroën.

But analysts say developing cars that consumers want will still be the biggest reason for any reversal of

Ford's fortunes in Europe. In 1994, Ford held 12.1% of the market. That share dropped in each of the next six years as executives in Detroit badly misread market trends. Ford, for instance, failed to produce a compact minivan. That is now the hottest segment in Europe. And Ford's contender in subcompacts, the \$12,100 Fiesta, is now 12 years old, nearly twice the age of rivals.

Scheele, a 35-year Ford veteran, made his mark in Europe by turning around the moribund Jaguar line. He was also behind the introduction of Jaguar's popular S-type. So with that strong background in new

products, one of his first moves was to speed up the launch of a new Fiesta by six months; it is now expected to debut in November.

Scheele hopes that, like the Mondeo, the Fiesta will help Ford of Europe end a reputation for dull cars and lackluster engines. For its beleaguered parent, a turnaround won't come a moment too soon.

By Christine Tierney in Frankfurt with Katharine A. Schmidt in Stuttgart



ATTRACTING ATTENTION

Nick Scheele, chair of Ford of Europe, won't call his \$1 billion restructuring a success, yet. But Detroit is noticing the results

worldwide auto operations. Still, Scheele—who is not commenting on the reports—hesitates to declare Ford's European turnaround a complete success just yet. For one thing, competition is heating up as Europe's overall car market shrinks. Sales are down 3% so far this year. Moreover, significant benefits from the restructuring will not show up until 2002. Consolidation of engine production at Ford's plant in Dagenham, England, and cutting assembly-line capacity on

A close-up photograph of three people's faces, partially obscured by a dark horizontal bar. On the left, a woman with dark hair and red lipstick looks down. In the center, a man with short brown hair and blue eyes looks directly at the camera. On the right, a man with dark skin and short hair looks down. They appear to be in a professional setting, looking at a computer screen.

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is airtight, and the doubters will ask how they did
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"THIS ISN'T A GAME WE'RE PLAYING AMONG OURSELVES"

The aggressive strategy of CEO Jacques Nasser has come under fire amid some highly publicized stumbles at Ford. On June 12, Nasser spoke with BusinessWeek's Joann Muller.

You set out to change Ford's culture. Has that been harder than you thought?

If transformation was easy, I think everyone would be doing it. Transformation is time-consuming. It needs constant reinforcement. It takes a lot of courage and many times requires new skills.

Are there too many initiatives under way at Ford?

It isn't a question of more initiatives. There will always be those that want to criticize. We can't let that deter us. This isn't a game we're playing among ourselves. This is something our cus-

tomers are demanding. Our core center around customer satisfaction, shareholder value.

That's not a flavor of the month framework to sustain leadership in this business. Six Sigma, lean manufacturing, e-business—they are not fads. They are tools, processes, technologies that support the best strategies and plans.

Ford dropped in the most recent Power quality rankings as well as the Harbour Report on productivity. What went wrong?

We do have a lot of work to do in reaching our own customer satisfaction



UNDAUNTED

Despite Ford's falling numbers, Nasser appears to have the board's support

engineered the vehicle and traced the problem to a screw that wasn't fully tightened. The true culprit? Workers were using the wrong power tool. Ford says Six Sigma saved it \$52 million last year, and it expects to save another \$300 million this year.

But if Six Sigma is so great, why isn't Ford's quality improving? Ford officials insist that it is—it just takes

ever-increasing price cuts. Some suppliers say the added pressure can lead to defects down the line. Speed is also a factor. A new car now takes about 28 months from drawing board to showroom, nearly half as long as it took a decade ago. In the rush to bring vehicles to market faster, Ford sometimes turns over its plans to suppliers before all the engineering and testing are completed, says the CEO of a major supplier. Last-minute design changes, he says, then put added pressure on suppliers, which can result in production screwups.

But Ford's internal strife is just as much to blame. "There has been so much emphasis on cost reductions, on task forces and new teams, that they lose sight of what's really important," says David E. Cole, director of the Center for Automotive Research in Ann Arbor, Mich. Over the past several years, Ford has lost many of its most experienced workers through buyouts and early retirements. That brain drain and the pressure to cut costs and move faster may explain errors like the one that caused the most recent Explorer recall. Despite extra quality checks to make sure the redesigned Explorer was free of defects, no one remembered during the planning stage to relocate a conveyor belt guide post on the assembly line to accommodate the 2.5-inch wider body. The result was a recall of 53,000 brand-new SUVs to check for gashes up to nine inches long in their tires.

Nasser believes that Six Sigma, the system for continuous improvement in quality and efficiency, will help Ford avoid similar mistakes in the future. Six Sigma relies on statistical analysis to get to the root of intractable problems. Ford began training managers in the technique a year ago and says the system has already produced results. Last year, for instance, one group tackled a nagging problem on the newly introduced Lincoln LS sedan: Why wouldn't the engine always start on the first try? Using Six Sigma, they reverse-

while for the improvements to show up, they say. "We've seen some very good results from Six Sigma projects so far, but there just aren't enough of them yet to affect broad-based results," says Richard Parry-Jones, group vice-president of global product development and quality.

Like quality, employee morale could also use a lift. Many Ford workers are upset that in a bid to shake up the culture, Nasser chose outsiders rather than Ford veterans for power management posts. He recruited J Mays, the hotshot designer of the redesigned Volkswagen Beetle, to head Ford's design stu-

WILL MAZDA EVER BE ANYTHING BUT A HEADACHE FOR FORD?

In Japan, where company loyalty is a virtue valued above all others, it was a disturbing sign. At 10 a.m. on February 19, Mazda Motor Corp., the beleaguered Japanese carmaker controlled by Ford Motor, offered early retirement packages to the first 1,800 employees who applied. That quota was filled by 10:01 as more than 2,200 workers rushed to sign up for the deal. More disturbing, those departing included some of Mazda's best and brightest. Among them: Norihiko Kawaoka, a top designer hired this month by Suzuki Motor Corp.

Mazda employees have a right to be

scared. Although the carmaker, the fifth-largest, finally turned a profit in 1998 and 1999 after five straight years of losses, that turned out to be a temporary reprieve. Earnings took a sharp dip again for the year ended in March with Mazda posting a record \$1 billion loss on \$17 billion in sales. Numbers were so bad Mazda cut dividend payments. It wasn't just deteriorating Japanese market sales sapped earnings. The red ink flowed from Mazda's operation in Europe and the U.S., which accounted for 45% of revenue.

didn't make any improvement power, while the industry averaged a 1.5% improvement. As for the Harbour Re-headlines are an indication of expectations for everybody else high expectations for Ford. Our city is the best, and has been. I know we got better last year. I'll continue to get better. You can't get on productivity and customer service on.

Jack business losing ground?
 Margins in the truck business have possibly been under pressure because of many competitors. But that's not the only reason for lack of success. In many ways, Ford has been successful in those markets. Our competitors are catching up to us. And we'll come charging. I've got a lot of faith in how our truck team is.

ed last year. The new policy requires supervisors to rank employees from best to worst along a curve: 10% get As, 80% Bs, and 10% get Cs. Getting a C means no bonus; two Cs or more is grounds for demotion or dismissal. Instead of measuring an employee's performance against a set of objectives, the employee is measured against others with similar performance—a radical change for a traditionally paternalistic company. The policy was intended to weed out underperformers and build a sense of teamwork. But employees say it has had the opposite effect. “If anything, this has caused extensive time-gazing rather than staring out at the horizon at the competitor and the competition,” says Pam Tucker, 48, a Ford lawyer and plaintiff in one of the class-action suits. “People are constantly looking over their shoulder.”

Nasser says the new job-review process is fair. “This is a company that has always had a policy of inclusion, going all the way back to Henry Ford.” But he adds that it's important for management to be candid

and plucked BMW's former president, Wolfgang Reitzle, to run Ford's beefed-up luxury-car business. Tichy sees the backlash as the predictable response to change and the inevitable resistance of entrenched managers. “You need to bring in new blood. It's how you change your DNA,” he says. “The Old Guard gets threatened and upset.”

Perhaps nothing has been more upsetting to Ford's middle managers, however, than the employee-evaluation system introduced

with employees about their performance. “A system that doesn't encourage that dialog in a positive way is a very cruel system, because you end up with employees who are not motivated, and maybe in the wrong positions. Then, when reality dawns, it may be too late.” Still, Nasser has heard the complaints and backed off some. Now only the bottom 5% of performers will get C grades.

Can Ford become the next GE? It's way too early to say. After all, Jack Welch spent the first decade of his tenure absorbing criticism for his relentless cost-cutting and layoffs. But Cole says the blueprint that eventually brought Welch great success may just be wrong for a company like Ford. With GE's diversified portfolio of businesses, it's easy to sell off the dogs. But a carmaker can't dump an underperforming marketing or design unit. “What Jack has tried to do is force-fit Ford into the GE model in a fashion that may not work,” says Cole.

The uproar over Nasser's initiatives underscores the difficulty and risks of trying to remake a company's basic values in a relatively short time. Convinced that successful companies in the Internet Age must move at Net speed, Nasser plunged headlong into a dizzying array of initiatives designed to reshape the century-old auto maker. CEOs at plenty of other Old Economy companies, from Procter & Gamble to Gillette to Xerox, were trying to do exactly the same thing when Nasser took the wheel at Ford: shake up the status quo and return their companies to their former greatness. But overhauling an entrenched culture is exceedingly difficult. Companies that have succeeded, such as Fannie Mae and Wells Fargo & Co., did so one step at a time, without making a lot of bold promises, says Jim Collins, author of the upcoming book, *Good to Great: Why Some Companies Make the Leap... And Others Don't*, due in October. “They weren't focused on changing the culture,” he says. “They were focused on changing the results.” He says that getting the rest of the company on board is the hardest challenge. “You have to focus on getting the right people on the bus and the wrong people off the bus, and the right people in the right seats.”

Nasser is trying to do just that. But with so much at stake, it's turning into a white-knuckle ride.

By Joann Muller, with Kathleen Kerwin and David Welch in Detroit, Pamela L. Moore and Diane Brady in New York



CEO FIELDS

Brought in from Ford, he is planning big cuts in staff and procurement costs and introducing new models at a rate of roughly one per month. Mazda won't introduce a single new offering this year. Instead, the company will hold off until 2002, when its introduction of new models will coincide

with a program to share vehicle platforms with Ford.

Despite its problems, Mazda expects to break even this year. Stronger sales of newer products such as the five-seat, five-door Tribute compact SUV in the U.S. and the “323” midsize sedan in Europe, will help. And the ex-Ford staffers, who manage Mazda, led by CEO Mark Fields, have promised the turnaround will be real this time. To do that, the carmaker is cutting procurement costs by 15%, production capacity by 25%, and the workforce by 10%. “Mazda now has to deliver and we realize that,” says David Thomas, Mazda's senior managing director for marketing. For Ford, Mazda remains what it has always been, more of a problem to solve than an opportunity to exploit.

By Chester Dawson in Tokyo

Ford bought a 25% stake in Mazda in 1979, the company then looked promising gateway to the Japanese market and a source of new technology in engines. But the company has never been a big moneymaker. Ford increased its stake to a 33.4% in 1996 and installed its CEO. “There are question marks about the role of Mazda in the Ford family,” says Howard Smith, auto analyst for Morgan Stanley Securities in Tokyo. Mazda still enjoys cachet for the styling of models such as the Miata and its unique rotary engine. But in Japan, Mazda has long been regarded as a mediocre product. Its home market are forecast to decline this year, to 280,000 vehicles. When Toyota Motor Corp. and Nissan Co. are rolling out new

MORGAN STANLEY'S MIDLIFE CRISIS

Scrambling to outflank emboldened rivals, the firm may end up buying a bank

Philip J. Purcell was in his element. On Jan. 25, the lanky 6-ft. 4-in. chairman and CEO described his dream to a crowd of 70 Morgan Stanley executives at The Boulders resort nestled in the sandy Sonoran desert foothills of Arizona. The firm, he said, should become the gold standard for financial services, just as Walt Disney Co. is for entertainment and IBM once was in computers. "To me, a great company is defined by the fact that it is not compared to its peers," says Purcell.

Purcell had reason to be upbeat. Just three days earlier, the firm's charismatic president and chief operating officer, John J. Mack, who had been president of Morgan Stanley before it was bought by Dean Witter & Discover Financial Services Inc. in 1997, told Purcell he was quitting. With Mack's resignation, one of the most bruising power struggles for the title of chief executive on Wall Street had ended abruptly. And to the surprise of many, Purcell had won. The rout was so complete that the board even refused to let Chairman Emeritus Richard B. Fisher speak to them about Mack's departure. Consolidating his victory, Purcell immediately put himself in charge of what had been Mack's domain: the investment bank.

Yet since then, McKinsey & Co. alum Purcell hasn't had much to celebrate. So far this year, Morgan Stanley's stock price has underperformed those of its peers by as much as 25% (chart, page 93). Now, analysts expect its second-quarter earnings to slide 37%, vs. 28% for its rivals, according to Thomson Financial/First Call Corp. And on Apr. 24, Purcell ordered the biggest staff cuts—1,500 of 65,600 employees—in Morgan Stanley's 68-year history. With initial public offerings and mergers and acquisitions stuck at less than half

LIGHTING UP BROADWAY

Purcell is trying to rally the troops at the new Manhattan headquarters. Morale is one of his biggest headaches





last year's levels, Purcell may be forced to make further cuts. Already, other banks are chasing after the firm's top guns by offering at least 25% more than they earn at Morgan Stanley. Since January, Deutsche Bank alone has hired four people above director level, including David Jacobs, head of the global consumer investment-banking group, in May.

LOADED FOR BEAR. Yet none of this is stopping Purcell from striking out in bold new directions. To regain Morgan Stanley's edge, the 57-year-old CEO believes it must do more than just beat "the boys downtown," its traditional investment-banking rival Goldman, Sachs & Co. He wants to take on huge financial juggernauts such as Citigroup and newly minted J.P. Morgan Chase & Co. That means Purcell may have to buy a commercial bank. Like other investment banks, Morgan Stanley is under increasing pressure to lend money to top corporate clients in order to snag lucrative investment-banking deals. "You either allocate enough capital to bank it yourself, or you buy a bank," says Purcell. To truly compete in the same league as Citigroup, Purcell feels he must also build up retail and asset-management franchises that outflank rivals everywhere from New York to Hong Kong to Munich. And in a brutally competitive credit-card market, he must either shed his Discover Card operations or build them up by digesting a rival—possibly as large as American Express Co., with a \$55 billion market capitalization (page 92).

Morgan Stanley is in the throes of a midlife crisis. Not since Purcell snapped up Morgan Stanley for \$10.5 billion in 1997 has the firm attempted to change so profoundly how it conducts business on so many fronts at the same time.

With Mack out the door, Purcell is finally free to implement the kind of business model he had in mind. If Mack had remained, says Richard K. Strauss, securities industry analyst at Goldman Sachs, the firm "would have focused more on corporate and investment banking." More than just bolstering credit cards, retail, and asset management, Purcell is reining in the macho deal-making culture that has defined Morgan Stanley.

He is changing compensation across the bank, preaching client satisfaction, bridging chasms between departments, and giving a younger generation of managers attuned to strategic thinking a bigger role in the business.

Still, the spirit of Mack the Knife, as he's known, continues to haunt the firm. Inside Morgan Stanley, there are rumors that Mack is being considered to succeed Citigroup's Sanford I. "Sandy" Weill or Merrill Lynch's David H. Komansky. Both firms decline to comment. There is even, perhaps wishful, speculation that he may come back to run Morgan Stanley again. If Mack lands at a rival, Purcell could end up more threatened than he was before Mack left. After all, Mack was responsible for building up the

firm's prestigious investment-banking franchise that garnered 64% of its \$8.5 billion in pretax earnings last year. And Purcell has yet to win the hearts and minds of the investment bankers. He angered many when he apologized in early February to clients upset that Morgan Stanley invited ex-President Bill Clinton to speak at a high-yield bond conference rather than back the decision. The department head concerned later left the firm. "No one on the institutional side would think to leave if Purcell left," says a Morgan Stanley banker who asks not to be named. "In fact, they'd probably have a party."

But Purcell has a history of proving naysayers wrong. After leaving McKinsey in 1978 for ailing Chicago retailer Sears, Roebuck & Co., he defied conventional wisdom by successfully launching the Discover Card in 1986 when there supposedly was no room in the market for another major credit card. Then, he made also-ran securities firm Dean Witter, spun off from Sears in 1993 with a market capitalization of about \$4.7 billion, strong enough to buy Morgan Stanley four years later.

WHIZ KIDS. Now, Purcell is clearly counting on staging an encore. "The way [our] businesses are going to develop is going to be different from what most people predict," he says, relaxed and smiling in his office towering over New York's Times Square. "It will play to our strengths." For example, Purcell

sees Morgan Stanley's fast-growing business of providing hedge-fund managers with pretty much all the services they need—clearing and execution of trades, accounting, and risk management—as a wave of the future. Morgan Stanley is now Wall Street's largest prime broker for hedge funds, serving at least 201 of them with aggregate assets of \$32.6 billion, according to a recent Hedgeworld research study of 998 hedge funds. (The next largest is Bear, Stearns & Co.,

partments. But in September, the firm will start to phase in rules that tie compensation to how big a share Morgan Stanley gets of the total fees each client pays to Wall Street rather than the absolute dollar amounts of transactions. Purcell is building a 32-story skyscraper on Seventh Avenue to consolidate Morgan Stanley employees spread around New York City. And he has enlisted a team of newly promoted whiz kids to create a system for serving clients.

thodically—and better. Many hard-driven strategic thinkers don't unlike Purcell. They think around broad concepts like "Hairy Audacious Goals" such as generating billions of dollars in new revenues. "Easily the most important thing I've done is hire people," says Purcell.

"HERCULEAN TASK." He wants his bankers to become so familiar with their clients that they can recommend financial solutions across equity and debt divisions as adroitly as

Amazon.com Inc. suggests books or other products to repeat customers. As a first step, Morgan Stanley is identifying its best clients across the firm. "If I go to see the CEO of Allstate now, and I want to know how much business we do with them, it's a Herculean task," says Purcell.

As one of two new co-heads of the investment bank, Vikram S. Pandit, Purcell's lead architect. On a table in his office, Pandit keeps a replica of the Rosetta stone, the key that enabled

HOW MORGAN STANLEY STACKS UP...

	2000 EARNINGS	2000 REVENUES	RETURN ON EQUITY	MARKET CAPITALIZATION* BILLIONS
CITIGROUP	20.00	70.37	27	\$251
JP MORGAN CHASE	8.73	31.83	16	87
MORGAN STANLEY	8.49	26.42	30	66
MERRILL LYNCH	5.70	26.79	24	51
GOLDMAN SACHS	5.31	16.59	27	43

Data: Putnam Lovell Securities, *BusinessWeek* *As of June 13

with \$22 billion in assets.) He wants Morgan Stanley to provide similar bundles of services to other customers such as pension and mutual funds, which he expects to become more like hedge funds in the future. "No one agrees with that. But that's how firms gain an edge," he says.

Under Purcell's command, Morgan Stanley has started to shake up its ranks. Until now, employees were paid handsome bonuses for landing deals or boosting the revenues of their own de-

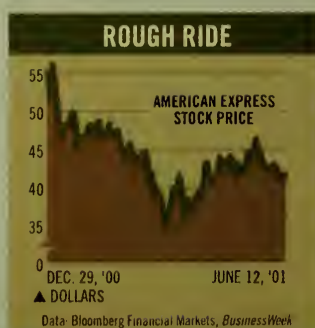
AMERICAN EXPRESS: READY TO DEAL?

It should come as no surprise that American Express Co. is being courted. Persistent market rumors put Citigroup, Morgan Stanley, and American International Group among its suitors. Although none will comment, AmEx' global presence, high-end consumer clientele, and relationships with corporations and small businesses could be attractive to each. And right now, AmEx is vulnerable.

Since Kenneth I. Chenault took the helm in January, the company's stock has fallen 20% to trade in the low \$40 range. Over the same period, the Standard & Poor's banking index has risen 2%. AmEx' fall is partly due to dwindling earnings expectations. On Jan. 22, the company pared 2001 profit forecasts, cit-

ing weak financial markets and a general economic slowdown. Then, on Apr. 2, it reported a \$185 million loss to its high-yield portfolio, which ultimately drove down first-quarter net income 17%. And on June 7, Morgan Stanley analyst Kenneth A. Posner further shaved 2001 estimates, warning that slowing overseas business would hurt the company's bottom line. As corporations worldwide cut back on travel and entertainment costs, AmEx is directly affected.

At the same time, investments that



AmEx made aren't panning. In 2000, it burned human resources spending in its special Advisors to \$2.1 billion, to revamp the mess—but AmEx is waiting to harvest returns. "The mess remains a challenging Bradley G. B."

dential Securities Inc. analyst, not looking for payback [for the special Advisors investment] until

The turn of events is especially on Chenault, who was named

eologists finally to decipher Egyptian
rogllyphs. To him, it symbolizes crack-
the code to better serve clients by
aking down barriers between differ-
departments. As a start, Pandit and
phan Newhouse, his fellow co-head,
re created a team of 15 fortysome-
ng managing directors who have
rked at Morgan Stanley an average
17 years. Most of them head tradi-
ial product divisions, such as fixed-in-
e or equities, while four are in com-
ely new roles focusing on strategy,
rketng, risk, and overseeing all re-
rch and analytical work. Other man-
ng directors are now re-
nsible for monitoring clients
h on client relationship com-
tees in separate divisions
across the entire invest-
t bank.

The most drastic reorganiza-
-within the investment bank
ar has been carried out by
Cruz, known as Cruise Mis-
-, who became head of the
d-income division in Sep-
ber. Since January, she has
the number of people who
ctly report to her to 8 from
By doing so, she shattered a
n of command that had been in
e for more than a decade. To keep
with the growing needs of rapidly
solidating clients, for instance, she
one person in charge of the fixed-in-
e division's high-yield, investment-
le debt, and securitization depart-
ts. "Clients started knowing more
at Morgan Stanley across our
lucts than we knew about them,"
Cruz. By reversing that equation,
z expects to drastically boost the

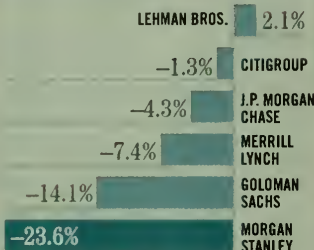
bank's share of global debt issuance.

Already, the new team has pulled off
a controversial deal that made Wall
Street sit up and take notice. In March,
they orchestrated the \$3.6 billion spin-off
of Agere Systems, Lucent Technologies
Inc.'s optical electronic unit, the fourth-
largest initial public offering in U.S.
history. Pandit's team not only had to
pick the precise moment when the deal
could be priced as telecom issues melted
down but also risked a complicated
debt-for-equity swap to raise the most
cash possible for Lucent. Morgan Stan-
ley essentially extended a bridge loan to

billion in existing credit lines from oth-
er banks. Ultimately, the deal paid off
handsomely. Goldman Sachs estimates
that, all told, Morgan Stanley received
\$75 million for the transaction. Morgan
Stanley executives declined to comment
on their fee. But they satisfied their
client: "Like most people, I'm skeptical
of bankers," says John T. Dickson, pres-
ident and CEO of Agere. "In this in-
stance, they earned the money." The
boldness of the deal also impressed
some skeptical competitors. "A lot of
firms probably could not have pulled
that deal off," says a senior banker at a

WORST OF THE LOT

CHANGE IN YEAR-TO-DATE
SHARE PRICE PERFORMANCES*



Data: Bloomberg Financial Markets

*THROUGH JUNE 12



EX-PRESIDENT MACK:
The surprise loser in a power struggle

Lucent by purchasing at one point as
much as \$2.3 billion of its debt to be ex-
changed for Agere equity at the IPO.
The tactic saved Lucent \$200 million in
taxes.

But when rumors started swirling
that Lucent was about to go bankrupt,
Morgan Stanley's stock plummeted. In
fact, Morgan Stanley was at less risk
than many initially thought. Most of the
debt was commercial paper with a one-
day maturity that was backed by \$6.5

for the firms' two distinct armies of bro-
kers—one from Dean Witter and one
from Morgan Stanley—four years into
the merger. Although the communica-
tions network necessary for Dean Wit-
ter brokers to access Morgan Stanley
research and IPO data was put in place
immediately after the merger, the two
back offices were never combined. "We
were in such a good market in 1997
that everyone said, 'Let's not screw it
up,'" recalls John Schaefer, who became



head of schedule. At the time,
Harvey Golub's early resigna-
-seen as an example of a per-
over. But now, it looks more
as though Golub ducked out

disappointing, he was optimistic about
new corporate card accounts and cost
savings. He assiduously avoided ad-
dressing the question of a merger.
American Express will not elaborate on

STORMY WATCH: AmEx' stock is off 20% since Chenault became CEO

just before things started
to get messy. And that
Chenault, after 13 years at
the company, finally has
won the top spot at what
might be exactly the
wrong time.

OLD MISTAKE? Now,
Chenault is under the gun.
At an Apr. 25 UBS War-
burg conference, he
stressed to investors and
analysts that although
first-quarter results were

its 2001 business plan for this story,
says spokeswoman Molly Faust, be-
cause the company does not want to
comment on merger rumors.

Selling out may not be Chenault's
only option. Despite the rounds of
megamergers in the financial-services
industry, there's no real reason why
American Express can't stand on its
own—and no compelling reason for it to
pair up, analysts say. In fact, if AmEx
were to merge with a broker, it could
just be making an old mistake all over
again. In 1993, American Express sold
off brokerage Shearson, and then in
1994 it sold Lehman Brothers Inc. as
part of a restructuring spearheaded by
Golub. "What has changed?" asks Brad
Berning, a U.S. Bancorp Piper Jaffray
Inc. financial-services analyst. If
Chenault knows, he's not saying.

*By Heather Timmons
in New York*



LEAD ARCHITECT Pandit is redesigning the investment bank from the ground up

you listen to executives in the division, they're as interested in buying other credit-card companies as they are in selling. "We will be bidders on international card portfolios as they become available," says David Nelms, head of the credit-card division. "In terms of being a seller, I think we provide great value for Morgan Stanley. There's a lot of value. I don't

believe Discover is worth more to someone else than it is to us."

In its foreign operations, Morgan Stanley's investment bank is top-notch. Where the foreign division falls down is in its retail, asset management, and credit-card franchises. So far, its only

the head of Morgan Stanley's retail division in September. "We woke up four years later, and we still hadn't taken care of the piping. It's hard to serve clients with a patchwork of operating systems."

Morgan Stanley's asset management division is also breaking down barriers. In May, it finished combining four different mutual fund groups and renamed the division Morgan Stanley Investment Managers, which has \$400 billion in assets under management. The change has given the group's portfolio managers much better access to the CEOs of major companies. "We get first call now," says Mitchell M. Merin, head of asset management.

MOUTHFUL. The credit-card division is the wild card in Purcell's strategy. Persistent market rumors have it that Morgan Stanley may sell its Discover unit or merge with American Express. Although Discover is just No. 5 in the business in the U.S., with \$47.6 billion in debt outstanding, Purcell does not feel that a major transaction in the near term is necessary. "It's a fine business," Purcell says. With a market capitalization of \$66 billion, it would be difficult for Morgan Stanley to swallow American Express, worth \$55 billion. "I'm not sure who would buy whom," says Guy Moszkowski, securities-industry analyst at Salomon Smith Barney. And many bankers doubt recently appointed American Express CEO Kenneth Chenault would want to work for Purcell. Meanwhile, if the U.S. District Court in Manhattan strikes down Visa and MasterCard rules that prevent thousands of banks from also offering Discover cards, Morgan Stanley's franchise would become much more valuable. Indeed, if

WHERE MORGAN STANLEY'S EARNINGS COME FROM

YEAR 2000
BILLIONS OF DOLLARS

Data: Putnam Lovell
Securities, pretax profits



European credit-card operation is in Britain. And it is little more than a niche player in European asset management, with \$40 billion in local funds under management. Morgan Stanley has a profitable institutional business in Holland, and it acquired a midsize Spanish retail broker called AB Asesores for about \$350 million in 1999 as well as a small British broker called Quilter Holdings Ltd. for \$235 million in 2000. In

CHINA WATCH
Newhouse must
protect the
firm's foothold
on the
mainland

addition, it is expanding a small, private-banking operation in Germany. Compared with the big Continental banks or even U.S. firms such as Merrill Lynch & Co. or Fidelity Investments, Morgan Stanley's asset management in Europe has a lot of ground to make up. "It's a question of walking before you run," says John J. Studzinski, deputy chairman of Morgan Stanley International.

SHRINKING IPO. In Asia, Morgan Stanley is wrestling with how it can maintain the relations that Mack had built over many years. Newhouse, not Purcell, has taken Mack's seat on the board of the firm's joint venture in China called CICC. Before Mack left, Morgan Stanley looked set to pull ahead of the pack by leading China Telecom's IPO, which was expected to be China's largest ever—a deal that Mack had closed. The Chinese government is now considering splitting the company into several different offerings. Nevertheless, "it will certainly be a multibillion-dollar transaction," says Mark Francescotti, head of Morgan Stanley's operations in Hong Kong. However, the IPO would be smaller than expected and could be delayed by up to 18 months.

Purcell has made an amazing journey from Sears Roebuck to Morgan Stanley. And it remains to be seen whether he can uphold the grandeur of one of the most famous names in investment banking. It's clearly his intention. Less than two weeks after Mack left, Purcell dropped Dean Witter from the firm's name.

*By Emily Thornton in New York
with Stanley Reed in London*



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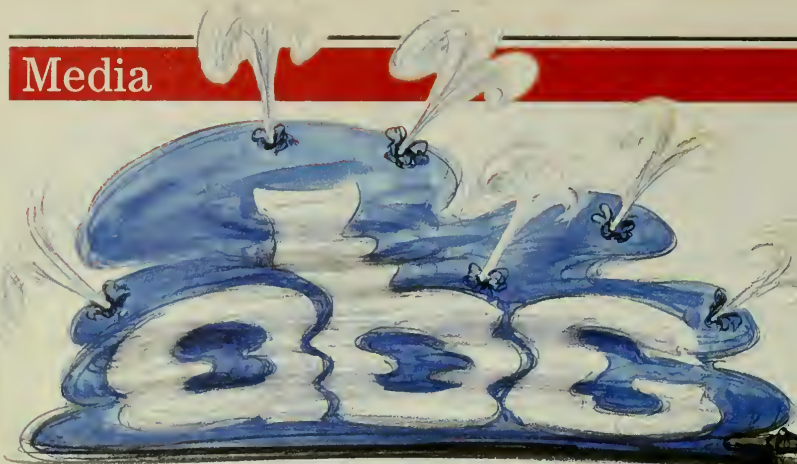
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NETWORKS

MILLIONAIRE: THE BILL COMES DUE

With ratings down, ABC is a victim of its own success

As a one-time boxing commentator, Alex Wallau likes nothing better than watching a good fight. But in his job as president of the ABC television network, Wallau now finds himself inside the ring. His network is sucking wind just a year after the record-breaking success of game show *Who Wants to Be a Millionaire* made ABC the big story in television. Waning ratings, cost-cutting, and morale issues have left the dethroned network reeling.

ABC's reversal of fortune became all too clear in late May as the sweeps period ended. Its share of the 18- to 49-year-old audience—the one advertisers really like—fell 30% from the year-ago sweeps (chart), the largest drop of any network. The problem? Besotted with *Millionaire*'s success, ABC aired Regis Philbin and his quiz show as many as four times a week. The show became overexposed, and its audience, which grayed from a median age of 42 when it first aired in mid-1999 to 56, skewed the entire network's demographics. Just since January, ABC's ratings in the coveted demographic are down 25%. "ABC is a victim of its own success and luck," says media buyer Rino Scanzoni. "*Millionaire* was like a drug. You take it and it feels great, but you've got to know it won't last forever."

SHARE PLUNGE. Now the Walt Disney Co.-owned network is scrambling to revive ratings by airing its quiz hit only twice a week and filling the time slots with hipper fare. And execs are rejiggering the prime-time lineup, including

stalwart *20/20*, in hopes of drawing younger viewers. After critics and audiences savaged its four new offerings last fall—all were cancelled—the pressure is on ABC execs to convince advertisers that it can get young again. Then there's Disney, anxious to quickly regain No. 1 network status as its shares have sunk 22% in the past year to around \$32, well below those of other media giants.

ABC's infatuation with *Millionaire* has a lot to do with what all networks are obsessed with: owning the shows they air. Networks increasingly favor their own programs to gain greater control and keep more revenue. Disney produces *Millionaire*, so it was hard not to blanket prime time with the popular show, say ABC execs. And it was cheap to produce—\$500,000 or less an episode, vs. \$1 million or more for a drama or comedy. "The totality of the [financial] impact was massive," says Wallau. *Millionaire*'s take so far: an estimated \$750 million in rev-

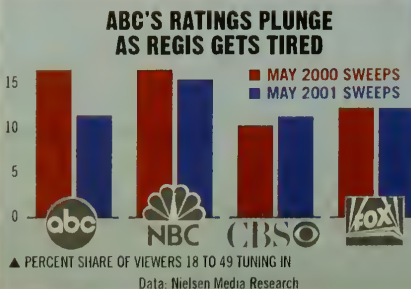
enues for Disney for over 270 episodes.

ABC may have gone for the easy money last year, but in this year's up-front ad season, in which advertisers buy the fall lineup, the bucks won't be flying so freely. By this time, advertisers should be buying like crazy. But a slowdown has them refusing to ante up until they get a better price. And networks aren't budging—yet. "It's a staring contest," says Wallau. ABC, with the biggest ratings drop, has the most to lose. Merrill Lynch & Co. estimates ABC's up-front revenue could be off by as much as 20% this year vs. last year, down to \$1.7 billion.

LEFT OUT? Adding to the network's plummeting morale is the fact that ABC, including its news division, which is being cut back. It can't help when ABC moved news magazine *20/20* from its 10 p.m. Friday stronghold to Wednesday at 10 for two months next fall. ABC hopes to draw younger folks to drama *Once and Again*, which will be in the Friday night slot. Furious *20/20* veteran Barbara Walters announced she would reconsider her option when her contract expires next year. Moving ABC headquarters from New York to Burbank last year to be near Disney central command only made New York-based news unit feel more out of the mix.

Still, network brass were able to persuade Burbank to fund some new, youth-oriented shows, including *Alias*, a drama about a grad student who doubles as a spy. That has Wallau feeling better about the network's fall prospects. The *Millionaire* hangover isn't likely to lift anytime soon.

By Tom Lo
in New York



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YOU NEED A DIFFERENT KIND OF SOFTWARE.

BASEBALL

THE MARINERS CATCH A TSUNAMI

By embracing all things Japanese, Seattle scores big



In this Cinderella season for the Seattle Mariners, one thing's for certain: July 28 is going to be a sellout. The Mariners (48-13 as of June 13) will play the Minnesota Twins that day, but the expected throng will have little to do with this battle of former cellar dwellers. No, sir, fans will be lined up for hours to get one of the Ichiro Suzuki bobblehead dolls being given away.

This year, the Mariners and Ichiro, their sweet-hitting rightfielder, have shredded more than the misconception that Japanese players can't handle Major League Baseball pitching. The team has also dispensed with some outdated notions about baseball marketing by embracing all things Japanese and turning itself into a merchandising dynamo.

At Safeco Field, fans shell out \$18 for a baseball cap with the words "water warrior" written in *kanji*. The hottest finger food is the "Ichi Roll," a \$9 spicy tuna roll from the sushi stand. Tourists from Japan arrive by the hundreds on packaged tours. And on June 8, more than 45,000 fans showed up for another promotional freebie—a *Sa Shin!* headband to celebrate last year's American League Rookie of the Year relief pitcher Kazuhiro Sasaki. (*Sa Shin!* is Japanese for "Strike Three!")

"MEANDERING." It's a remarkable turn about from 1992, when the woeful Mariners were on the brink of leaving the Northwest and Nintendo CEO Hiroshi Yamauchi agreed to purchase the club as a gift to Seattle, home of Nintendo of America. His largesse set off a firestorm. Japanese carmakers were continuing their march on Detroit, U.S. landmarks such as New York's Rockefeller Center and California's Pebble Beach had fallen into Japanese hands, and just two days before the Mariners bid was announced, Japan's Prime Minister Kiichi Miyazawa criticized American workers as "too lazy." Baseball bloods railed about selling out America's pastime to the Japanese, and Philadelphia Phillies owner Bill Giles declared his opposition, saying: "It's a patriotic issue for me." Polls in Seattle and across the country showed most fans didn't want Japanese ownership, either.

MLB ultimately agreed to Yamauchi's 60% acquisition, but only under the condition that he limit his voting interest to 49%. His American partners had to keep the majority voting stake, a restriction that was eliminated in 1996. "It was a meandering path, and not particularly distinguished one," says former Commissioner Fay Vincent. Others are more blunt. "It was out-and-out racism and ignorance," says Japan ex-

bert Donald Hellman, director of the Institute for International Policy at the University of Washington.

Oh, what a difference a decade makes. Japanese is virtually a second language at Safeco Field, the team has a Japanese-language section on its Web site, and when closer Sasaki takes the mound, TV broadcasts write his name in *kanji* above his stats. Nintendo even has an ad in *kanji* behind home plate.

Buying the club isn't the only debt Seattle owes to Yamauchi. Although he has yet to attend a Mariners game, Yamauchi is new enough about marketing to suggest that the club pursue the Japan League's seven-time batting champ. The second gift Mr. Yamauchi has given the people of Seattle is that he was the one who suggested we go after Ichiro," says team CEO Howard Lincoln. "I don't think any one of us Americans at the Mariners really understood the impact this one guy could have. We just didn't get it."

They do now. Ichiro, the only major leaguer to wear his first name on the back of his jersey, is among the American League leaders in batting average, hits, runs, and stolen bases. And his popularity is boosting the Mariners' bottom line. Everything from \$6 Ichiro posters to \$500 Ichiro autographed baseballs are flying out of concession stands and stores. "On a monthly basis, our team store sales are off the charts," says Lincoln, who declines to disclose specific numbers.

WAVE IN JAPAN. The Mariners' success isn't just tied to Ichiro, though. Sasaki and such other Mariners stars as designated hitter Edgar Martinez, second baseman Bret Boone, and pitcher Aaron Sele are sparkling, too. All are from a team that lost three of the league's hottest players in the past three years—Randy Johnson, Ken Griffey Jr., and Alex Rodriguez—is expected to begin the season to chase the division rival, the Oakland Athletics. Instead, the M's are pursuing victory. They've gotten off to the second-fastest start ever, with only the 12 New York Giants winning more of their first 60 games.

Ironically, the owners, who put up so much opposition to Yamauchi's acquisition, may benefit most. That's because

When Nintendo bought the team in 1992, critics railed about selling out the national pastime

international TV and merchandising rights are held by the league, not individual teams. So the yen flowing in from Japan is shared among MLB's 30 teams. "It's been great for everybody," says Commissioner Bud Selig.

MLB is in the middle of a five-year deal with the Japanese networks that accounts for the lion's share of the \$65 million it expects from international TV rights this year. "The opportunity really comes after this," says Paul Archey, MLB vice-president for international business operations. In 2003, to be precise. That's when a bidding war will break out among Japanese TV networks

vying for rights to carry the games featuring Ichiro. With Ichiro in the lineup everyday, all Mariners games are now broadcast live in Japan, and they're so popular that attendance is slumping at many Japanese ballparks.

"When Ichiro's on TV, it's like the rest of the league doesn't

matter," says Japanese baseball expert Robert Whiting, the author of *You Gotta Have Wa*.

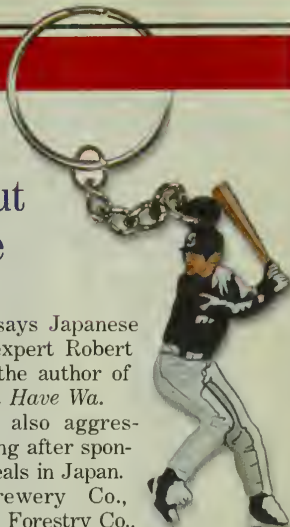
MLB is also aggressively going after sponsorship deals in Japan. Kirin Brewery Co., Sumitomo Forestry Co., and a handful of others have shelled out millions to use the MLB

logo. The players have climbed on the gravy train, too. Over the winter, Ichiro signed a three-year, \$14.1 million contract. He can earn \$5 million more in performance bonuses, many of which he seems likely to hit. Sasaki is in the middle of a three-year, \$9.5 million deal. Already prominent pitchers in Japan, Ichiro and Sasaki are now fielding offers from U.S. companies. "I have 30 clients, and I'm spending 98% of my time on these two guys," says their agent, Tony Attanasio. "[Ichiro and Sasaki] experienced immense adulation in Japan for years. But they didn't expect their success here to be as fanatical." Why, it's enough to make their heads bobble.

By Jay Greene in Seattle, with Ken Belson in Tokyo



A MAGNET—and not just for fridges



ICHIRO key chain



DOUBLE THREAT: Ichiro excels as a fielder, too

Developments to Watch

EDITED BY OTIS PORT

NANOWIRED TO FERRET OUT EXPLOSIVES

EVERY HOUR, A LAND MINE kills or maims as many as three people. Tens of millions of these deadly devices are scattered across 70 countries.

Chemists at the University of California at San Diego believe they may have a cost-effective solution for ferreting out land mines and other bombs. By encasing a silicon-based polymer in conductive molecules, they've developed a nanowire that can detect very faint traces of explosives

in air or under water. When the polymeric wires—each only 1/2,000th the diameter of a human hair—are sprayed on filter paper, they normally glow under an ultraviolet light. But the glow gets switched off by even trace amounts of an explosive—on someone's hand, for example (top), or coming from hidden explosives. So a surface coated with the substance, combined with a

portable UV lamp, would create a small bomb detector that can find sea mines and booby traps along beaches, or spot guns in airline baggage or at border checkpoints.

A DARK SHADOW WARNS OF TNT

A system based on this technology should be less costly to make than existing approaches, says biochemistry professor William C. Trogler, who assisted with the research. *Arlene Weintraub*

STRONGER THAN STEEL, THINNER THAN A HAIR

FEW MATERIALS CONJURE an image of strength better than steel. But peering into his electron microscope, Northwestern University's Laurence D. Marks can visualize tiny tubes that are twice as strong as steel, yet 1,000 times thinner than a human hair. Marks, director of the university's Center for Transportation Nanotechnology, is a team that scored a first in imaging and analyzing a new class of nanostructures made of hexagons of boron and nitrogen atoms.

Marks foresees the boron nitride nanostructures finding a home in the aerospace industry. The molecules are similar to their better-known cousins, carbon nanotubes. Both have walls only one atom thick. And because of new nanostructures that are tough, light, and flexible—like the carbon variety—they could be used to coat gears in aircraft or rocket engines, for instance. But here's the difference: When a carbon nanotube oxidizes, it produces carbon monoxide and carbon dioxide—not useful engineering terms, and perhaps even harmful. When boron nitride oxidizes, on the other hand, the molecule forms boric acid, which is an excellent solid lubricant. Applications can be found taking it commercial will be easy," Marks says.

The boron nitride won't be the first big breakthrough. Marks's federally funded work, which opened in November. Next, he hopes to work on nanostructures composed of molybdenum disulfide. This compound is an even better solid lubricant, so Marks expects that it could be especially handy in space—keeping antennas and other movable parts on satellites from freezing. *Michael A. Leary*



A LUCKY STRIKE AGAINST TUBERCULOSIS

PEOPLE SEND SALEH A. NASER UNUSUAL SUBSTANCES. From the mountains of Russia and the jungles of Vietnam, plant extracts gathered by herbalists and shamans flow into the molecular biology department at the University of Central Florida, where associate professor Naser tests them for efficacy against drug-resistant strains of tuberculosis. He has studied some intriguing compounds over the years. But none compares to a substance that's common in North America: nicotine. "We've looked at thousands of compounds, from natural sources and synthetic," he says. "By far, nicotine is the most effective I have ever seen in the test tube."

Naser, who gets no money from tobacco growers, says he and his team stumbled onto nicotine's antibacterial activity while studying proteins in the leaf. Not knowing which of the compounds in the plant were responsible, they tested nicotine—which has other medicinal effects—and immediately hit home. "We're sure it's the active ingredient, and it's extraordinary how small the required amounts are," Naser says. He is planning further tests in tissue cultures and lab animals. *Neil Gross*

INNOVATIONS

■ For afflictions such as mad cow disease, which are caused by deformed "prion" proteins, there is no positive diagnosis until after the patient dies. But scientists at Serono Pharmaceutical Research Institute in Geneva, reporting in the June 14 issue of *Nature*, think they can diagnose these diseases in living patients by speeding up the proliferation of prions in a test tube containing a sample of spinal fluid. If any dangerous prions are present in the sample, then in just hours their numbers will increase to an extent that would normally take 30 months—the time required to spot abnormalities in people and animals.

■ Noting that handheld vacuum cleaners now make up 40% of all vacuum sales, Dallas-based Electrolux plans to cut the cord on its full-size vacuum cleaners. To do so, the company, which isn't part of Sweden's Electrolux, has designed cleaners that use fuel cells—gadgets that generate electricity from a chemical reaction between hydrogen and oxygen. Small snap-in tanks will hold enough hydrogen to last for a month or so. The new sweepers, due in 2003, will be priced between \$300 and \$1000. □

the **FUTURE** of **BROADBAND**

Inside:

Remote Site Impact
How Options Compare
Wireless, Optical Roles

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B R O A D B A N D

Fast-Food Networking:

Broadband To Go

Over the next few years, connections will go into the air, the home and the taxicab. Are you ready?

It's just a few days shy of September 9, 2004, and Gina Jones is running late for her 5 p.m. New York-to-Los Angeles flight. Flipping open her hybrid cellphone/handheld, she watches just enough of her department head's video conference to chime in with a quick comment. She's bumped to first class and decides she'll have room to review a few inventory and sales issues on the flight. Gina pushes the synchronize button on her laptop just before she leaves the terminal, hoping to get the latest post-5 p.m. inventory database figures before she boards. She could update the figures on the airplane, but she wants to avoid the surcharge. As she boards the airplane, Gina is happy to see Gerry getting on board, too. Even though he'll be sitting 20 rows behind her, she'll use the airplane's LAN to share her slide presentation with him, and they will be able to make changes before they arrive in L.A. As a precaution, Gina will back up the encrypted presentation file to the corporate network as soon as she steps off the airplane.

Although Gina is fictitious, those technology capabilities will be very real in just a few years. Beyond the all-but-obligatory speed increases, broadband soon will be available in as many places as workers need to be. As the futuristic Captain Kirk of the starship Enterprise would have said, "Broadband is soon going to have to go where no LAN has gone before."

Indeed, corporate executives — plotting how to fulfill their future communications needs — have a difficult time because there are so many possibilities these days. Plentiful and useful live and interactive multimedia, plus multi-Terabyte databases that will want to be refreshed constantly, will push how quickly companies will need broadband connections. But the more daunting change is that the workers who need to access the data will be moving themselves. Some will be corporate telecommuters, others will be working in small offices



near major clients and still others will serve as road warriors, working from hotel rooms, client offices, airports, train stations, taxicabs and their own cars. (See sidebar, "The Remote Site Challenge," on page 8.)

The future of broadband offers great opportunities, as long as executives think about and plan for it in advance. Executives will have exciting new tools for sales, marketing, product development and other business tasks that can be enhanced or simplified by using broadband. But issues of security, robustness, pricing and coverage will continue to arise, and it's important to watch the changing landscape.

One issue is the very meaning of the word "broadband." Today, it generally means T1 speeds (1.544 megabits per second) or better. The meaning, however, is evolving into a relative measurement, as opposed to an absolute speed. In the future, the true meaning is literally to transmit at a speed faster than

BY GABRIEL ALLAN AND EVAN SCHUMAN

Stay in touch

Make life easier

Delight your customers

e-CRM. It's the Next Generation Internet

Developing a close bond with existing customers is proven to be the easiest and most cost-efficient way to grow your business. And now, with wireless technologies and the Internet coming together, endless opportunities abound to deliver convenience to your busy, always on-the-go customers. Mobile e-CRM solutions from **Siemens Information and Communication Networks** allow you to serve your customers via an ever-changing, ever-growing range of devices, networks and applications. As the world's largest supplier of business communication solutions, we're used to delighting customers.

Perhaps we can help you do the same.

mobile business

B R O A D B A N D

The Remote Site Factor

As more employees move into the field, broadband connections become trickier.

Planning for broadband connections used to be fairly simple. The vast majority of corporate employees needing such connections were in one of a handful of nice, neat, mini-headquarters locations, often housing thousands of employees.

But things are much more complicated for the 21st Century broadband planner. A wide range of business conditions has eliminated those simple, nostalgic days. Such corporate needs as getting employees closer to customers, cutting travel costs and strengthening personnel recruitment/retention packages have pointed to the distribution of employees to many smaller sites — potentially even one-person operations.

The last few years also have brought companies technology enablers. Among them are wide use of the Internet (and its popular virtual private network capabilities) and low-cost, fast means of using it, such as DSL variants and cable modems.

The U.S. mobile and remote workforce has been growing steadily for years and is projected to include some 55 million workers by 2004, according to industry analyst firm International Data Corp.

One of the many challenges is how to treat the growing number of

remote sites. Are they tiny fiefdoms that decide their own technology issues, or are they simply a part of the extended corporate WAN?

With the ever-expanding kinds of devices that people use to connect to the corporate office, these issues are becoming even more formidable. Remote sites are not just about laptops anymore — they also require

are being re-argued.

And then there are the critical people issues. How can remote workers, for instance, stay in the loop without a water cooler to congregate around? Cisco Systems, which has a large telecommuter program, assigns new engineers a "mentor-buddy," who helps them learn the ropes and introduces them

TIPS

Pay Twice, Sleep Through the Night

Buy redundant DSL lines from competing DSL providers. This way, when there is a glitch, you can switch to the alternative unless the problem is with the regional Baby Bell. It also will allow for stronger fee negotiations, as you'll have precise, comparable data about an alternate provider.

fat pipes to cellular telephones, handhelds and home computers.

Denise Shiffman, a marketing vice-president with Sun Microsystems, sees the answer in dataless clients that rely on constant and robust wireless connections.

The data, she argues, will "live online," not on a hard drive in a single device. Is that a radical new concept or just a new face for dumb terminals? All of the arguments about the balance of client-server

to colleagues. During team meetings, detailed minutes are kept and distributed by e-mail.

Joseph Roitz, AT&T's Telework director, maintains that most managers already have direct-reports who reside in other locales. The key to a successful remote-worker program, Roitz says, comes down to "managing by objectives, challenging the status quo and embracing innovation."

— Joe Mullich

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B R O A D B A N D

(continued from page 7)

court of last appeal for locations where no other technology can reach; but it only works where there's a clear southern exposure. That means it may not work in either mountainous areas where DSL doesn't reach or downtown areas with tall buildings where cable has yet to be laid. That's why satellite-based broadband will be the solution for only a tiny percent of the population. (See chart, on page 6.)

Broadband will require careful resource allocation, too. Suppliers speak enthusiastically of the convergence of voice, data and video in the same pipeline. They promise more variety, flexibility and better price-

band networks to much more cost effective but less sturdy options such as cable modems, DSL and wireless, reliability will be an issue. And this is reliability as measured by conservative business standards, where an outage of a few hours can cost a company millions of dollars.

DSL and cable providers boast about their systems being "always on." Perhaps a better description would be "always on unless something has gone wrong somewhere." The reliability of these technologies has been weak, even by consumer standards.

Not that the lack of reliability has slowed acceptance of these technologies. Given that the only alternative has been 56k analog modems, broadband interest by consumers has been soaring. A report released in late May from Statistical Research showed the percentage of U.S. households with broadband access — via cable modem, DSL or DirectPC satellite — had nearly doubled in the prior six months.

Broadband service suppliers are getting better about installing gear, too. Abhi Ingle, vice-president of product development and marketing for broadband provider Covad Communications, a subsidiary of Covad Communications Group, says: "Just a year ago, when we installed a line, we had to run two trucks — the first for the line; the second for our equipment. It was both expensive and painful. Now that we share the customer line, we are able to eliminate both trucks."

"It's that last mile that's the challenge," says Wild-Blue's Moore. "Whether it's cable, DSL or satellite." Satellite providers work hard at reliability because half of each company's equipment is up in space. "You can't roll a truck up to a satellite," he says. Satellites have other problems, too: Disruptions are truly an act of God, because weather conditions such as heavy rain can wreck havoc with satellite communications.

But executives who are not prepared for the imminent tidal wave of broadband changes may face no less of a disaster. Just like Gina's fellow fictitious character, *The West Wing's* President Jed Bartlett, discovered, blaming God won't help. ■

TIPS

Location, Location, Location
When scouting for new buildings, identify the switch distance for DSL options, ask the cable provider about cable modem support and remember that satellites need a southern exposure and a direct line of sight.

ing thanks to increased competition. But users have a habit of devouring all available bandwidth. Without proper planning, such practices can end up turning broadband back into narrowband. Not to mention that one pipeline means putting all corporate communications eggs in one potentially fragile basket.

In the next few years, pure fiber networks reportedly will deliver some 50 gigabits per second, which is about five times faster than today's fiber networks. "That's the dream for the next several years: fiber to the curb," says TI's Hughes. To have the ability to deliver "better than Ethernet-class connectivity to the terminal points of the network." Most corporate PCs are linked via a standard Ethernet connection that runs at roughly 10 megabits per second.

Bruce Miller, a senior product manager at Lucent Technologies, points to efforts at Bell Labs running several hundred gigabits per second. "Terabits per second are possible over pure fiber. These speeds are available and dormant until they are turned on," he says.

Not everybody agrees that fiber-optic speeds will extend to corporate PCs and other devices at the end of the network. "You'll see optical grow in backbones and at some of the edges," says Dave Zatoulak, vice-president of network services for Hughes Network Systems. "But the last mile? That's just a pipe dream."

As corporations need to extend their current broad-

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TEARDOWNS,
THE REIT
MARKET,
TIME-SHARES

BusinessWeek Investor



Should You Tear The Darn Thing Down?

Sometimes it pays to raze your home and build a new one

BY PETER COY

Although their first child is due in just a few weeks, Neil and Rebecca Cadman of El Segundo, Calif., aren't putting a lot of work into sprucing up their 80-year-old bungalow. Come September, they're going to move out and "scrape it to the dirt," says Neil Cadman, a property manager. For close to a year, they'll be living nearby, maybe with Neil's dad. On the 50-foot by 200-foot site of their 1,100-square-foot, three-bedroom house, they're going to build their dream abode—a 4,000-square-foot, Mediterranean-style villa with five bedrooms and "probably" six bathrooms.

Even if you're not going to make like the Cadmans

and bash your house to bits, the nationwide tear-down phenomenon is something you need to know about. Before sinking a lot of money into renovating an older house, you should investigate whether it would be more sensible to buy elsewhere and sell your property to a builder.

While there will always be a market for cute little fixer-uppers, most buyers today value big homes with big, modern kitchens

expressed interest, too. Teardowns represent the triumph of size over sentiment. While there will always be a market for cute little fixer-uppers, most buyers today value big homes with big, modern kitchens



rooms. According to the National Association Home Builders, the average newly built home is 2,305 square feet of floor space, up 53% from 900 square feet in 1970—even though the size the average family has shrunk 15% or so over the period. Teardowns are most common in desirable older neighborhoods where the real estate market is tight and demand for big, modern houses exceeds supply. While some towns, such as Naperville, Ill., and Birmingham, Mich., have resisted the onslaught of “bigfoot” McMansions that spoil the character of neighborhoods, others welcome the renovation of their housing stock and additions to local property-tax rolls.

Whether you're selling, buying, or renovating, the key is to know when a house is a bad candidate to tear down. Don't go just by price: In some super-hot markets, even \$1 million houses are being razed. A house has “teardown” written all over it if it's small for the neighborhood, in bad shape, has an old-fashioned layout with a small kitchen and too few bathrooms, or is a lot with room for a grander house.

A house is most likely a goner if the property on it is worth far more than the structure. Buyers see big yards as wasteful, since many buyers are happy with econobox starter mansions and postage-stamp lawns. Likewise, large, hand-cut trees can be the enemy of the house they live in: They raise the lot's value and increase the price someone will want to build a mightier house on it. On the other hand, houses are less likely to be torn down if they're soundly built, modern features can be added for a modest cost, they have historic character in an area that values authenticity.

DO LIST. Think twice before tearing down your own house or buying a house with the intention of tearing it down. It's a lot riskier than buying an existing house, where you know exactly what you're getting and how much it will cost. Most teardowns are done by professional investors on speculation, and even pros can run into unforeseen problems with permits, construction, or a soft real estate market.

If you still want to do a teardown, go house-hunting first to see if you can find what you want in the market, and how much it would cost. That sets the upper limit for how much you should spend on a teardown project, says Martin Stone, a real estate broker of Buckingham Investments in El Segundo and co-author, with colleague Spencer Kessler, of *The Unofficial Guide to Real Estate Investing* (Hungry Minds, \$15.95).

Have a reputable builder or architect assess your house you're living in—or looking at—to tell you whether it's smarter to renovate, start from scratch, or walk away. The fee for a thorough evaluation could be as high as \$3,000 or \$4,000, but it's well worth it, says Douglas Andrus, broker-owner of Prudential Grosse Pointe Real Estate Co. in Michigan.

Make sure local zoning ordinances will let you build the house you want. Keep in mind that zoning laws may not allow you to expand as much as you'd like. In some cases, even the current footprint of your house may be too big for construction under zoning laws passed after

it was built. Also, remember that if you build a house, you'll probably need a construction loan—a credit line that gets converted into an ordinary mortgage when the house is finished.

It's a daunting list of to-dos. But it didn't scare off the Cadmans, who are partners in an El Segundo property-management firm called Cadman Group. Financially, the decision to tear down and rebuild wasn't an obvious call. They bought their house four years ago for \$268,000 and recently received an unsolicited offer of \$450,000 for it. That's money they could have used toward buying an existing house. But they didn't want to leave the neighborhood. Plus, they think they'll still come out ahead if they can stick to their budget of \$400,000 to tear down the existing house and build the new one, which they think will have a market value of close to \$900,000. They're saving money by acting as their own general contractor, using subcontractors who work for Cadman Group. And they didn't have to pay an architect. A relative who's a structural engineer did the building plans.

If you see a wave of teardowns in your area, enjoy the ride, because it may not last. In such



Make sure zoning laws will allow you to build the home you'd like, keeping in mind that they may have changed since the existing house was built

Home Wrecker!

When Tearing Down A House Makes Sense...

- The house is structurally unsound—for instance, beams are rotten and wiring and plumbing are antiquated
- A renovation that solves all the house's problems would be prohibitively expensive
- The house is on a large or attractive lot
- The house is less valuable than others in the neighborhood
- You like the neighborhood too much to leave

...And When It's A Bad Idea

- Buyers in your area will pay extra for historical authenticity
- The house has features that would be difficult to recreate
- The replacement would be substantially more valuable than neighboring houses
- You can get the features you want with a modest renovation
- You aren't sure you will stay long enough to justify the effort and expense of a teardown

neighborhoods, builders often do the teardowns and put up new houses on spec. To make money, they have to build houses that are more expensive than others in the area. As long as those new houses keep selling, they pull up prices of existing properties. But when the market says enough already, builders pull out, and the merry-go-round stops, says Ken Lampton, a broker at RE/MAX Premier Realty in Dallas.

For now, that's not a problem. Sales of new and existing homes are running at a record pace this year despite slowing economic growth. The demand for choice parcels of land is unabated. So before you invest another dime in your beloved old house, it behooves you to think hard about whether you'd be better off moving out—and handing the keys to some guy with a bulldozer. □

REITs: A Chat With A Champ

Martin Cohen's firm manages some \$5 billion worth



Martin Cohen is the dean of real estate investment trusts (REITs). His New York firm, Cohen & Steers Capital Management, manages \$5 billion in REIT mutual funds and separate accounts—making him and partner Robert Steers two of the nation's largest REIT investors. Cohen, 52, recently discussed the REIT outlook with Staff Editor Lewis Braham.

Are you concerned that a recession could stymie demand for real estate?

Demand would certainly decline. But historically, at this point in the economic cycle, there has been a lot of overbuilding. This is the first cycle that I know of where that hasn't happened. There's no oversupply of real estate in most major cities. Also, if you consider that, with the exception of hotels, most leases are long term—5 to 10 years for offices—then even a slowing economy is not going to have a major impact on REIT earnings. But you need to treat each real estate sector separately.

Which sectors do you favor now?

We still like offices, particularly in high barrier-to-entry markets where there's not a lot of

building: New York City, Boston, Chicago, Washington, D.C. We also, interestingly, like hotels. One reason is that the supply of hotel rooms is moderating just as the Federal Reserve is easing interest rates. It looks like at some point in the next 12 or 18 months, we'll see stronger economic growth by virtue of the stimulus. And since hotels are the most economically sensitive, I think they'll do very well.

What hotels are you buying?

We like FelCor Lodging Trust and Host Marriott, the largest hotel REIT. Our biggest position is Starwood Hotels & Resorts, which is not a REIT but a hotel operating company. All three have high-quality real estate portfolios, excellent management, and strong balance sheets. Starwood, in particular, has terrific brands and great overseas exposure.

And offices?

Clearly, we like Equity Office Properties, which is the largest office REIT and the largest REIT altogether. We also like Vornado Realty, the largest office owner in New York City. We've recently developed an affinity for Southern California offices, which are holding up well

spite the California energy crisis. Are you a fan of Vornado Realty? It is the biggest player in that region.

THE VIEW

FROM HERE:

Cohen sees a lift for hotels in the next year or so

Are there any sectors you're avoiding?

We avoid spec-

ulative areas such as mini-warehouses, movie theaters, and bowling alleys. These are property types that can get overbuilt pretty quickly.

At the start of 2000, REIT stocks traded at discounts to their underlying property values. Where are they now?

They were trading at about a 20% to 25% discount, on average. They're now trading at about 10%. Historically, their market values have equaled their property values. So they're attractive from a valuation standpoint.

How safe are REIT dividends now?

I just did a little study on that. In 1993, REITs were paying out 86¢ for every dollar in cash flow as dividends. Today, they're paying out 61¢ of every dollar. That means cash flows would have to decline industrywide by 39% before dividends would be affected. That has never happened even in the 1990-91 real estate depression.

Do you expect dividends to rise soon?

You should see a definite acceleration. Bonanza Properties, another favorite of ours, just raised its dividend by almost 10%. You'll see a lot more of that.

"We still like offices, particularly in high barrier-to-entry markets where there's not a lot of building: New York City, Boston, Chicago, Washington, D.C."

REAL ESTATE

Time-Sharing Ready For Prime Time?

The entry of big players has eased the pressure tactics

PALLAVI GOGOI

I was enjoying a stroll through historic Charleston, S.C., when I was offered \$100 to attend a two-hour presentation. Sure, I thought. Why not? Big mistake. I soon found out why time-share was a much-loathed word among vacationers. I spent the next three hours listening to nattily dressed salespeople use every bit of charm and arm-twisting under the sun to sell me part-ownership in a vacation home. In that high-pressure atmosphere, I was urged to sign a contract on the spot or lose a

"special" 15% discount. Some people succumbed, but most, like me, left with a bitter aftertaste.

REAL ESTATE

That was three years ago, even though the entry of hotel chains such as Marriott International, Four Seasons, Hilton, Ritz Carlton, Starwood, and Walt Disney into the time-sharing business starting in the mid-'80s was supposed to have cleaned up the industry's act. "We have a great deal at stake. Our reputation rests on our thoughtful way of communication, and we're not willing to sacrifice that," says Duffy Keys, senior vice-president at Four Seasons Residential Properties.

Indeed, these companies have softened the pitch and don't even use the T-word anymore. Instead, they call them interval or fractional ownerships, or vacation and private-club residences. Their offerings have more flexible exchange privileges than what developers allowed earlier—say, swapping your ski condo in Vail, Colo., for a beachfront unit in Aruba. They'll even let you trade your time-share week for a stay in one of their hotels or for airline tickets.

You can also find a deal to suit every budget. On the high end are the private-club residences of Ritz Carlton in Aspen or St. Thomas in the U.S. Virgin Islands, which start at \$90,000 for a peak-season week. Folks with young children might prefer buying into one of Disney's

five resorts, which cost as little as \$11,500 and go as high as \$150,000. Marriott sells intervals at 51 resorts for \$7,500 to \$60,000.

Hard sell or soft, the basic pitch is the same. For what you'd pay to rent a room or condo at a resort over the next five years or so,



as such as Hilton, Four Seasons, Marriott, Ritz Carlton, Starwood, and Walt Disney may let you trade for a stay at one of their hotels or for airline tickets

Time-Share Tips

- Buy at a vacation spot that you wouldn't mind returning to year after year.
- Visit the facility and inspect the unit before you buy.
- Choose peak-season weeks at brand-name resorts. That gives you the most flexibility if you want to exchange or rent out your unit.
- Do not view a time-share as a real estate investment, since time-shares generally lose value. The flip side: Consider buying resales from owners.
- Ask about maintenance fees and other additional costs you could be hit up for, such as repairs and cleaning.
- Don't commit any money unless you're sure. Read the contract carefully and have your own lawyer review it.

you can buy the right to use that room or condo on a particular week year after year. On the surface, it seems reasonable. But the purchase price isn't the only cost (table). Every year, you'll also pay maintenance fees that could run from \$225 to \$1,000 per unit per week, plus repair and cleaning costs. And as a practical matter, you have little recourse but to pay whatever the management company asks. And not every time-share goes on into perpetuity. Disney's expire in 2042, so your grandchildren may not be able to visit with Mickey and Minnie the way you did.

As an investment, forget it. "People shouldn't expect it to appreciate in value, as there are too many of them around," says Robert Webb, an attorney in the time-share industry and a partner at Baker & Hostetler LLP in Orlando. "You buy it to enjoy it. It's like a car—use it, but it depreciates in value." Indeed, a sampling of time-share resale ads on such Internet sites as eBay show asking prices that are 50% or more below what time-share marketers are selling new units for. EBay listed about 143 properties recently, including a two-bedroom ocean-view villa in Cancun's five-star Royal Islander resort that the owner would sell for \$10,000 a week, even as the management company says it has a resale value of \$19,500.

WEB HELP. Anyone considering fractional ownership should visit the Web sites devoted to time-sharing. Time-share Users Group's www.tug2.net is a good spot because owners, not marketers, run it. Besides checking out what's for sale, you can pick up good information on the pros and cons of ownership. Timesharedirect.com is just a compilation of listings. If you're leery of the sales pitch you're getting, read the Federal Trade Commission's guidelines on time-shares at www.ftc.gov/bcp/online/pubs/homes/timeshr.htm.

Despite the industry's claims to the contrary, there's plenty of evidence that sales practices haven't improved all that much. Michael Blumenfeld, CEO of Dallas sporting-goods company Collegiate Pacific, was attracted to advertisements for the Four Seasons' "interval ownerships" because he liked staying at Four Seasons hotels while on business trips. Last November, he called for a sample sales contract. But he claims the Four Seasons rep would not send a contract for examination until Blumenfeld put down a 10% refundable deposit on a \$150,000 time-share at the company's Punta Mita resort in Mexico. Blumenfeld said he was

taken aback but went for it anyway and charged the \$15,000 on his credit card.

After reviewing the contract, Blumenfeld says he felt the ads showing several resorts were misleading, considering most of them were finished and he couldn't choose the actual apartment he could come back to year after year. He took his money back and now owns a time-share at a villa with an ocean view in Los Cabos, Mexico, run by the Auberge Resorts LLC.

Four Seasons spokesman insisted that the company doesn't ask for money, "but someone is just interested in seeing a sample contract and that it requires a 10% deposit only when a potential buyer signs up."

NOW OR NEVER? Why do time-share sales have to be so high-pressure?

The thinking is that people are excited to be free during a vacation and more likely to buy at a place they like to visit than when they go back home to their lives. "The developers feel like if they don't get you when you're on vacation, they've lost you," says Jake Hoeschele, an insurance lawyer in Minneapolis who

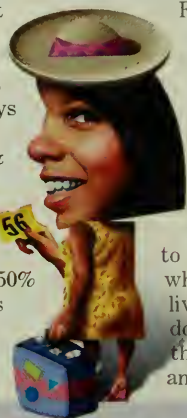
ran a time-share business in the 1970s but is now a time-share owner with Marriott.

Some companies lure people with promises of allowing them to swap their time-share for vacations at other organizations such as Interval International or Resort Condominiums International. But if your unit isn't located in one of the most desirable, name-brand places at a choice time of the year, you may have to wait months to get the swap you want.

Most hoteliers also allow exchanges within their own works—and you don't necessarily have to take somebody else's time-share. In fact, Disney and Starwood time-share owners' points based on their cost that they can use

for hotel stays, river-rafting trips, or safaris. So people choose to rent out their time-share rather than swap, but if the management company finds you a tenant, it will take as much as half of the rental fee. And resorts that are trying to maintain an air of exclusivity, such as Carlton's, don't allow rentals.

The key to buying a time-share is to do so at a place where you like to take vacations. You'll be best off if you buy peak-season times at known resorts. And you'll be more satisfied with your purchase if you do it at your own pace—not with a high-pressure salesperson on your back.



Comparing Costs

A one-bedroom villa for one peak-season week at Marriott's Grand Vista resort in Orlando

FOR THE TIME-SHARE	
20% DOWNPAYMENT ON \$17,500 PURCHASE PRICE	\$3,500
FINANCING 80% OF PURCHASE AT 8%*	20,383
CLOSING COSTS	400
ANNUAL MAINTENANCE FOR 10 YEARS**	7,684
TOTAL	31,967
AVERAGE COST PER YEAR	3,197
FOR THE RENTAL	
ONE WEEK'S RENT	\$1,900
TOTAL FOR 10 YEARS***	30,281
AVERAGE COST PER YEAR	3,028

*Using a 10-year home-equity loan on your primary residence

**First-year maintenance of \$640, plus 4% annual hikes

***Assumes 10% annual increases

Data: Marriott International, BusinessWeek

REAL ESTATE

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THESE SPIN-OFFS COULD BE PIN-UPS



BY ROBERT BARKER

rb@businessweek.com

Three upcoming offerings promise to unlock buried value.

Done right, they could create a stir in a humdrum market

Spin-offs, carve-outs, bust-ups, and all the other corporate weirdness that on Wall Street go by the bland name "special situations" can be a royal pain to understand. They also can prove uncommonly profitable. Chemical company Cabot, for example, last year spun off a unit that makes compounds used to polish semiconductors. Before the deal, Cabot had a \$2 billion stock-market value. Today, the market values of Cabot and Cabot Microelectronics total \$4 billion.

One guy who spotted that situation early is Joe Cornell, who heads Spin-Off Advisors, a Chicago research and hedge-fund firm. Amid the market's new sobriety, the flow of such deals is dwindling a bit, yet plenty of opportunities remain. Cornell told me he expects fewer carve-outs, or two-stage spin-offs. The first step is an initial public offering of, say, 20% of the stock in a unit a parent company aims to divest. In a second step, the parent distributes the remaining 80% interest to its shareholders via a special dividend.

But with a cool IPO market, Cornell is seeing more straight spin-offs that go right to step two. "Those offer more opportunity anyway," he said. "When you get investment bankers involved in the IPO, more people pay attention." A case in point is Roxio, a maker of CD-burning software that parent Adaptec initially planned to carve out via an IPO. Instead, in May, it went ahead and spun off all of Roxio directly to Adaptec shareholders.

Roxio initially traded as high as \$17 but soon started sinking; it scraped a bit under \$11 before edging back above \$12. In its fiscal year ended on Mar. 31, Roxio saw sales jump 57%, to \$122 million; cash earnings grew 53%, to nearly \$24 million, or \$1.45 a share. Roxio's software already comes installed on many new computers.

Johnson & Johnson's move on May 23 to buy most of Inverness Medical Technology is creating a fresh spin-off. While J&J will keep Inverness' abetecare unit, it aims to spin off other units: women's health, nutritional supplements, and clinical diagnostics. Christopher Schulz, analyst with institutional research service The Spin-Report, told me that the spin-off part of Inverness posted \$8.7 million last year in earnings before interest and taxes, on \$54 million in sales. If J&J finishes the deal as planned, it will pay Inverness shareholders \$35 in J&J stock plus one share of Inverness stock in the spin-off. With Inverness near \$36, investors give little value to the spin-off, which Schulz sees starting with \$1.05 a share in cash.

Some top investors have long dreamed of



CASTLE KEEP: The Fairmont Banff Springs Hotel

Canada's industrial giant, Canadian Pacific, would find a way to uncover the value of its many odd parts. That dream seems farthest from being realized as CP gets set to spin into five pieces this fall. In "the starburst," as the company calls it, investors will get separate shares in petroleum, railway, coal, shipping, hotel companies, the last of which includes management of such luxe spots as the Fairmont Banff Springs Hotel and New York's Plaza.

Such super-cheapskate investors as Southern Asset Management sold CP after its stock got a quick boost from news of the bust in February. It's now near \$40, but Cornell says Schulz sees a bit more hidden value; they estimate CP's post-starburst value range at \$43 to \$48 a share. That potential gain may look modest, but it's not a riskless proposition. CP awaits a ruling from Canadian tax officials on the plan; any delays would push the payoff further off. Likewise, the Inverness spin-off is in an early stage, and Roxio's challenges include competitors. In the same, these are three lower-risk situations that look, well, special.

Special Situations

COMPANY SYMBOL	RECENT PRICE*	NOTES
CANADIAN PACIFIC CP	\$40.00	Busting into five separate companies and stocks
INVERNESS MEDICAL IMA	36.36	Deal with J&J could create undervalued spin-off
ROXIO ROXI	12.20	Growth in market-leading CD-burning software

*June 12

Data: BusinessWeek

BusinessWeek online

For barker.online, go to www.businessweek.com/investor/ and click on "Columnist's Picks."

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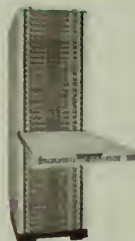
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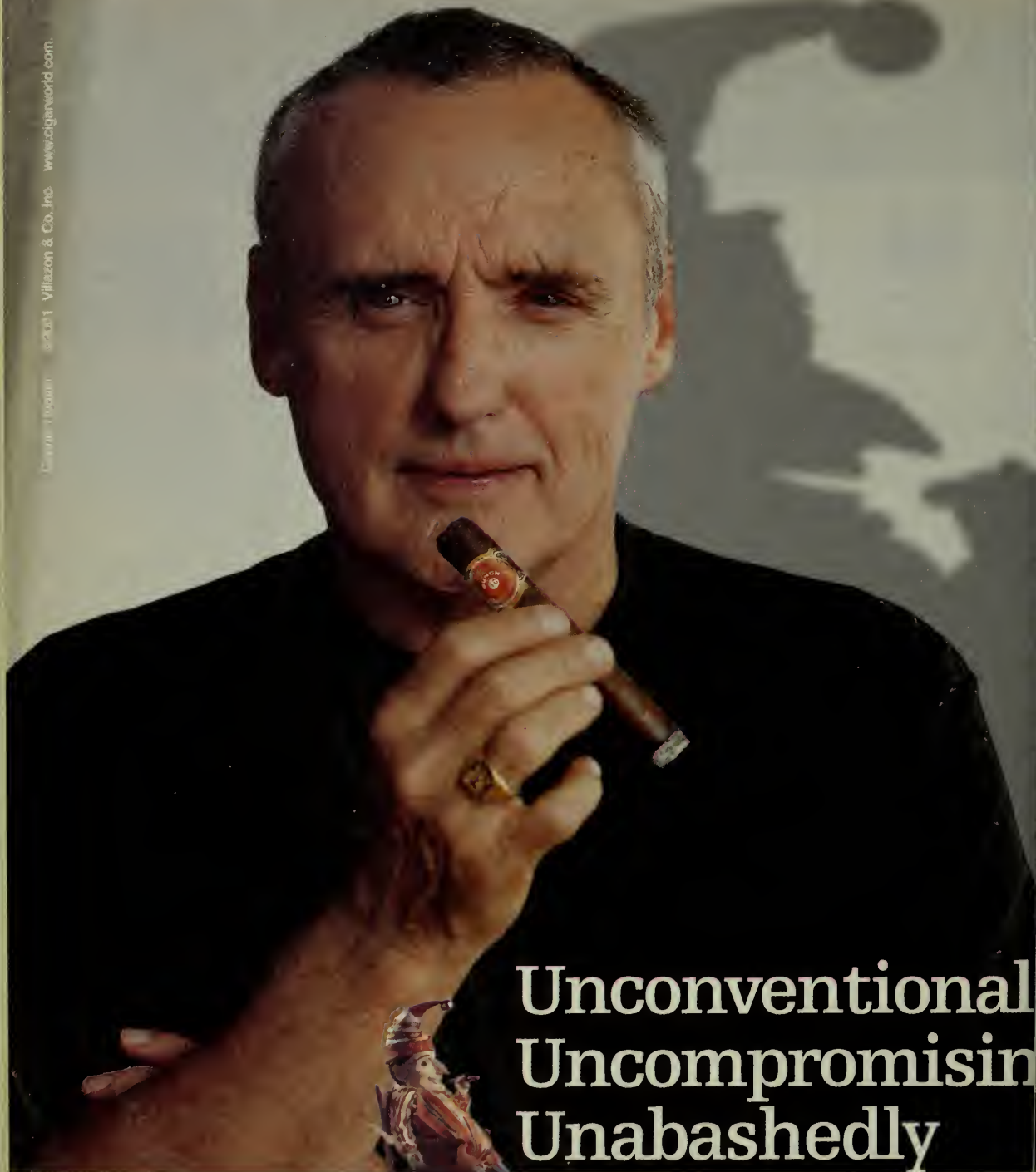


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And Heart Disease.

MAKING EYES AT IVAX



GENE G. MARCIAL

x' drug pipeline
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y cases. And
romedia's
ge may be
ning an LBO

If there is anything that inspires investors' confidence in Ivax (IVX), it's CEO Phil Frost's "nose for products and deals," according to Nissim Aboodi, president of money manager Questrium Corp. Ivax, a developer and maker of generic and branded pharmaceuticals, has 34 applications before the Food & Drug Administration, thanks to Frost's constant search for new products. As for deals, Frost's latest acquisition, LabChile, a major drug outfit in Latin America, should boost earnings in 2002.

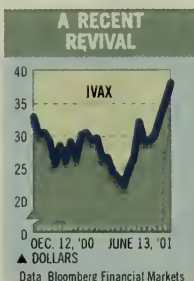
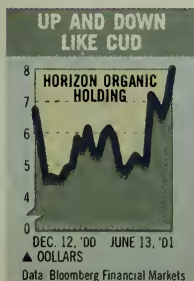
But the deal investors are really anticipating: an Ivax merger—with the likes of GlaxoSmithKline or AstraZeneca, two companies said to be eyeing Ivax. Frost, who owns 12% of Ivax, "is shareholder-oriented and receptive to good ideas—including the sale of Ivax," says Harvey Eisen, a former investment adviser to Citigroup's Sandy Weill and now president of Bedford Oak Advisors. Frost is 64, so it isn't unthinkable that he'll do a deal, he argues.

When this column featured Ivax on July 15, 1999, the stock was at split-adjusted 7. It is now trading at 37, and Aboodi thinks it could double in 18 to 24 months. "Ivax has blockbuster drugs in its pipeline," he says, including TP38, a novel immunotoxin drug for brain cancer, and paclitaxel, a generic version of Bristol-Myers Squibb's anticancer drug Taxol. Ivax has also developed a system to deliver paclitaxel orally. Early tests on TP38 indicate "encouraging results," says Aboodi. Phase I and II clinical trials are under way, and because of the drug's importance, it could get a fast-track process at the FDA, says Aboodi.

Ivax is becoming more focused on branded products, notes Merrill Lynch's Gregory Gilbert. That should bring higher margins and more sustainable growth, says Gilbert, who sees Ivax earning \$1.15 a share in 2001 and \$1.35 in 2002.

HORIZON'S BRIMMING ORGANIC MILK PAIL

The big supermarkets have been allotting more shelf space to organic food, and that's just how Horizon Organic Holding (HCOW) envisions that the organic market will evolve. The products of Horizon, which include organic milk, cheese, yogurt, and fruit, are in 45% of all markets in the U.S., says Carole Buyers, an analyst at Tucker Anthony Sutro Capital Markets. Horizon's growth prospects remain strong, she says, because of new



products, expanding organic dairy sections at the nation's supermarkets, and rising prices of nonorganic dairy products. She rates the stock, now trading at 8, a "strong buy." Buyers says the stock is worth 11, based on 11 times cash flow.

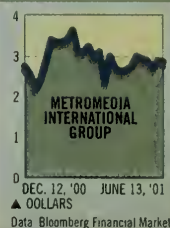
With the stock trading below that of its peers and its earnings gaining momentum, the stock has become an attractive buyout target, says Buyers. "While we don't have reason to think an acquisition is imminent, other natural-organic beverage and dairy companies have been acquired at much higher multiples," notes Buyers. She says Horizon is worth about 15 in a buyout, or 16.8 times cash flow. One possible buyer, says Buyers, is Suiza Foods, the largest U.S. maker of dairy products. It also makes fruit juices, bottled water, and coffee. Suiza, which owns a 12% stake in Horizon, says it doesn't comment on its acquisition plans.

WILL KLUGE PREVAIL AT METROMEDIA?

Remember Metromedia Inc.? Billionaire John Kluge took it private in a leveraged buyout in the mid-1980s for \$1.2 billion and then sold it for \$6.5 billion a few years later. Kluge held on to the name Metromedia, and he now heads a company trading on the American Stock Exchange as Metromedia International Group (MMG). It operates communications businesses in China, Eastern Europe, and parts of the former Soviet Union. But the company has been in the red since 1997, and its stock is on the skids, down from \$5.12 a year ago, to \$2.85 now. In November, 1995, Metromedia traded as high as 18.

What's the scoop? Some pros say Kluge, who is chairman of Metromedia and owns 19.6%, plans to take the company private. But a group of shareholders is opposing the idea. The group, led by Elliott Associates, which owns 3.9%, and Lens Investment Management, an activist in corporate governance, is waging a proxy fight to name two of its own directors to Metromedia's nine-person board. The group says five of the directors are corporate insiders. So it warns that any LBO will be tilted in favor of Kluge's own interests and not those of shareholders. The opposition figures the stock is worth at least 9 a share. But the company has yet to call an annual meeting. Meanwhile, management has hired Salomon Smith Barney and ING Barings to provide advice on either selling or spinning off some of MMG's assets. Stay tuned.

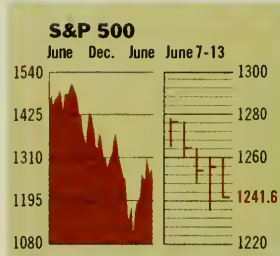
WAY DOWN FROM AN EARLIER HIGH



BusinessWeek online

Read Gene Marcial's Inside Wall Street Online column Tuesday afternoons at www.businessweek.com/today.htm. And see him Fridays at 1:20 p.m. EST on CNNfn's *The Money Gang*.

Stocks



COMMENTARY

Not fun: Those are the best words to sum up this week's market. All three indexes ended up in negative turf, with the Nasdaq down 4.3%, the S&P 500 down 2.2%, and the Dow finishing down 1.8%. Reasons for the downward charge: nasty earnings warnings from tech and telecom heavyweights like Juniper Networks and Nokia, coupled with economic pessimism.

Data: Bloomberg Financial Markets
Bridge Information Systems, Inc.

U.S. MARKETS

	June 13	Week	Year to date	Last 12 months
S&P 500	1241.6	-2.2	-6.0	-15.5
Dow Jones Industrials	10,871.6	-1.8	0.8	2.4
Nasdaq Composite	2121.7	-4.3	-14.1	-44.9
S&P MidCap 400	521.0	-2.4	0.8	5.9
S&P SmallCap 600	228.3	-1.2	4.0	9.6
Wilshire 5000	11,509.5	-2.4	-5.5	-15.9

SECTORS

	June 13	Week	Year to date	Last 12 months
BusinessWeek 50*	860.6	-2.4	-11.3	-30.2
BusinessWeek Info Tech 100**	473.3	-4.7	-16.3	-50.7
S&P/BARRA Growth	616.4	-2.4	-10.3	-30.3
S&P/BARRA Value	624.9	-2.1	-1.8	1.9
S&P Energy	952.9	0.1	2.3	8.2
S&P Financials	155.8	-2.6	-5.4	9.5
S&P REIT	92.7	1.9	5.4	14.1
S&P Transportation	696.9	-5.1	-0.1	18.7
S&P Utilities	311.8	-0.9	-11.1	14.6
GSTI Internet	130.4	-7.3	-28.2	-73.9
PSE Technology	739.1	-4.9	-9.3	-32.8

*Mar. 19, 1999=1000 **Feb. 7, 2000=1000

BEST-PERFORMING GROUPS

	Last month %	Last 12 months %
Hospital Management	14.9	107.7
Toys	14.8	74.4
Health-Care Services	11.8	63.8
Metal & Glass Containers	9.5	63.2
Pollution Control	9.1	62.7

EQUITY FUND CATEGORIES

4-week total return	%	52-week total return	%
Leaders			
Health	7.8	Financial	24.5
Latin America	7.6	Small-cap Value	23.0
Real Estate	4.5	Mid-cap Value	20.7
Precious Metals	3.9	Real Estate	19.2
Laggards			
Japan	-6.5	Technology	-48.2
Europe	-4.4	Communications	-48.0
Foreign	-3.8	Japan	-33.3
Communications	-3.8	Diversified Pacific/Asia	-28.2

EQUITY FUNDS

4-week total return	%	52-week total return	%
Leaders			
World GenomicsFund com	15.1	Schroder Ultra	94.4
iShares NASDAQ Biotech.	13.5	Potomac Internet Short	89.6
Rydex BioTechnology Inv.	12.7	CGM Focus	73.5
Evergreen Health Care B	11.9	Bost. Part. Sm. Cap Val. II	70.8
Laggards			
Monument EuroNet A	-14.4	ProFunds UltraDTC Inv.	-84.6
American Heritage	-14.3	Jacob Internet	-77.4
Cr. Suisse Warb. P. Jap. Gr.	-13.2	Firsthand Communications	-73.2
Jundt Mid Cap Growth A	-12.0	Potomac Internet Plus	-72.9

Data: Standard & Poor's

GLOBAL MARKETS

	June 13	Week	Year to date	Last 12 months
S&P Euro Plus (U.S. Dollar)	1173.1	-2.2	-17	
London (FT-SE 100)	5820.2	-1.4	-6	
Paris (CAC 40)	5353.6	-2.6	-9	
Frankfurt (DAX)	6111.9	-1.3	-5	
Tokyo (NIKKEI 225)	12,823.5	-2.7	-7	
Hong Kong (Hang Seng)	13,523.3	-0.4	-10	
Toronto (TSE 300)	8012.7	-2.2	-10	
Mexico City (IPC)	6802.4	0.2	20	

FUNDAMENTALS

	June 12	Wk. ago
S&P 500 Dividend Yield	1.25%	1.22%
S&P 500 P/E Ratio (Trailing 12 mos.)	29.4	29.3
S&P 500 P/E Ratio (Next 12 mos.)*	22.0	22.4
First Call Earnings Revision*	-3.67%	-2.61%

*First Call Corp.

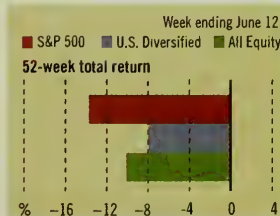
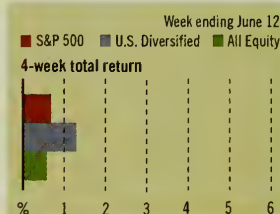
TECHNICAL INDICATORS

	June 12	Wk. ago
S&P 500 200-day average	1319.1	1325.0
Stocks above 200-day average	73.0%	74.0%
Options: Put/call ratio	0.70	0.65
Insiders: Vickers Sell/buy ratio	2.67	2.57

WORST-PERFORMING GROUPS

Instrumentation	-13.3	Communications Equip.	-13.0
Communications Equip.	-13.0	Semiconductors	-12.6
Homebuilding	-12.6	Long-Dist. Telecomm	-11.5
Natural Gas	-11.5	Instrumentation	-7.9
Invest. Banking/Bkrgve.	-7.9	Metal & Glass Contain	

Mutual Funds



Data: Standard & Poor's

THE WEEK AHEAD

NEW RESIDENTIAL CONSTRUCTION Tuesday, June 19, 8:30 a.m. EDT ► Housing starts in May likely slipped to an annual rate of 1.6 million, from 1.61 million in April. That is the median forecast of economists surveyed by Standard & Poor's MMS, a unit of The McGraw-Hill Companies. The projected rate would be above last May's 1.57 million.

LEADING INDICATORS Wednesday, June 20, 10 a.m. EDT ► The Conference Board's composite index of leading indicators

probably climbed 0.2% in May, after rising 0.1% in April.

FEDERAL BUDGET Wednesday, June 20, 2 p.m. EDT ► The U.S. Treasury is expected to report a May deficit of \$8.5 billion, following a record surplus of \$189.8 billion in April.

INTERNATIONAL TRADE Thursday, June 21, 8:30 a.m. EDT ► The April trade deficit in goods and services is expected to remain virtually unchanged at \$31 billion, from

\$31.2 in March. Based on the S&P median forecast, exports fell in April after dropping 1% in March. Imports expected to decline after jumping in March.

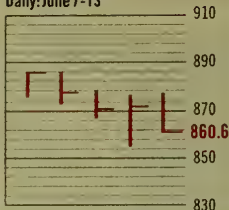
CURRENT-ACCOUNT DEFICIT Thursday, June 21, 10 a.m. EDT ► The U.S. current account deficit probably narrowed from the first quarter to \$107 billion in the fourth. Even so, the deficit will equal a hefty 4.2% of the economy.

BusinessWeek Fifty

Dec. June

Daily: June 7-13

Weekly



down 2.4%, was no garden party this week. Only 11 out of the index' 50 stocks ended up in pos-
The best performer was Cardinal Health, up 4.0%, continuing an upward trend that started a year
cluded Scientific-Atlanta, down 19.4% after an analyst downgrade. Tellabs was down 14.5%, as
acted to the Juniper warning, and as UBS Warburg cut estimates on the stock.

COMPANY PERFORMANCE

Company	% change		Rank	Company	% change	
	Week	Since 3/1/01			Week	Since 3/1/01
International	-0.7	3.0	26	Verizon Communications	-1.5	10.7
o Petroleum	-1.5	-6.0	27	Alza	-1.4	29.0
	1.2	-0.6	28	Citigroup	-3.8	2.5
	-4.3	-2.0	29	Sun Microsystems	-7.7	-19.0
Materials	2.1	18.6	30	Merck	-1.1	-8.3
n Financial	-4.4	9.8	31	El Paso	-1.6	-20.4
tal Petroleum	-0.7	24.0	32	Altera	-0.5	3.0
	-4.1	-7.3	33	Marsh & McLennan	-0.6	-0.7
Gee	1.9	9.5	34	Household International	-1.1	11.7
	-8.8	-27.5	35	Chevron	1.0	11.9
Brothers Holdings	-5.0	-0.3	36	SBC Communications	0.6	-7.6
	-10.4	-29.4	37	Mercury Interactive	-10.0	0.5
	-1.3	-23.3	38	ADL Time Warner	-1.4	17.2
laboratories	-5.0	5.7	39	Washington Mutual	1.4	8.1
ton Financial	-4.0	-3.9	40	General Dynamics	-2.8	13.1
echnology	-1.4	13.9	41	Comcast	0.5	-6.2
	-4.0	4.6	42	Morgan Stanley Dean Witter	-7.9	-6.6
Hess	0.3	17.2	43	Tellabs	-14.5	-37.5
ergy	0.6	0.6	44	Exxon Mobil	0.6	10.5
communications	-7.6	-30.6	45	Scientific-Atlanta	-19.4	-6.9
ne Financial	-4.0	14.0	46	U.S. Bancorp	-2.6	-3.2
Petroleum	-1.9	16.1	47	Paychex	-5.7	-7.3
ervices	-9.4	7.0	48	Merrill Lynch	-6.9	1.7
ources	-0.4	-4.7	49	Bed Bath & Beyond	-3.7	16.6
Health	4.0	12.2	50	Texas Instruments	-4.2	5.0

Production Index

Change from last week: -0.7%
Change from last year: 0.9%

INITIAL OUTPUT Jun. 2=171.1 1992=100

The index is a 4-week
moving average

Oct. 2000 Feb. 2001 June 2001

in index lost more ground in the latest
calculation of the four-week moving aver-
dropped from 170.5 to 169.4. After sea-
ents, trucks and autos were lower, as
se sales declining further in June. Elec-
lumber production also fell on the week.
I refining, and rail-freight traffic were
the week. The May index fell sharply to
4.6 in April.

ch of the index components is at www.business-week.com
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BusinessWeek (ISSN 0007-7135) published weekly, except for one week in January and August, by The McGraw-Hill Companies, Inc. Executive, Editorial, Circulation, and Advertising: 1221 Avenue of the Americas, New York, N.Y. 10020. U.S. subscriber rate \$54.95/year, Canada \$69/year. Periodicals postage paid at New York, N.Y., and at additional mailing offices. Postmaster: Send address changes to BusinessWeek, P.O. Box 430, Hightstown, N.J. 08520.

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WHAT TO DO ABOUT GLOBAL WARMING

Global warming is one of the most partisan issues in America. Conservatives and liberals have fought bitterly over it: The Right expresses outrage at any international climate treaty, such as the Kyoto Protocols, that it sees as imposing limits on U.S. sovereignty and economic growth. The Left blames Big Business for being greedy and neglecting a problem that threatens the world.

When President Bush took office, he rather peremptorily dismissed the Kyoto Protocols, which mandate caps on carbon dioxide and other greenhouse gases in Europe and the U.S. Europe, which approves the caps, was enraged. To his credit, Bush did order up a new National Academy of Sciences (NAS) report on climate change. The full report acknowledges that global mean temperature is up from a century ago, atmospheric levels of CO₂ have risen over the past 100 years, and CO₂ is a greenhouse gas that warms the earth. It says CO₂ probably plays a key role in warming but states that given uncertainties surrounding the level of natural variability in climate temperature and other factors, "a causal linkage between the buildup of greenhouse gases in the atmosphere and the observed climate changes during the 20th century cannot be unequivocally established." The data "is suggestive of such a linkage, but it does not constitute proof of one..."

Given these scientific facts and conclusions, both liberals and conservatives, can reasonably conclude that while it may not be time to panic, it would be prudent to begin curbing CO₂ emissions. That can be done with a policy that relies heavily on incentives backed by some punishment for severe polluters. We now have hybrid-car technology that doubles gas mileage. We have ways of increasing the energy efficiency of commercial buildings, which use half of all electricity in the U.S. Emissions trading is a proven mechanism. The energy efficiency of air conditioners can be improved.

President Bush has accepted the scientific findings of the NAS report. It is not enough to simply be critical of the Kyoto Protocols. If they are deficient, Bush must end the politicization of the global warming issue and actively move to common ground in solving the problem.

PROTECTIONIST TRUSTBUSTERS?

As the global economy becomes ever more integrated, Europe and the U.S. appear to be taking divergent paths on antitrust policy. Should Japanese, Mexican, or Chinese regulatory officials choose to apply their own distinctive national standards to merging American or European companies that do local business, everyone would face an inter-

national babel of antitrust regulations. That could only be for investment, capital flows, and competition.

It is, of course, in the name of competition that the European Commission has been scrutinizing the General Electric Co. merger with Honeywell International Inc. European antitrust policy opposes mergers that result in companies selling an array of goods and services within one industry. The Honeywell deal would result in an aerospace behemoth that offers airline customers jet engines, avionics, and financing in one bundle. The EC worries that smaller, individual European aerospace companies may not be able to compete against such "portfolio power." That such a stance smacks of protecting European companies against U.S. competition does not appear to bother the EC all that much.

U.S. antitrust policy focuses on consumer benefits. Vertical mergers, or even near-monopolies such as Microsoft that benefit consumers pass regulatory muster more easily. The notion is that competitors can take care of themselves in the global marketplace without government help.

In an ideal world, antitrust policy would be coordinated among nations to avoid the Tower of Babel effect. Fairly put, the EC and countries around the world should question whether their antitrust policies are truly pro-competitive. They are, in fact, a new form of protectionism. In the end, protectionism is just as dangerous in capital markets as it is in markets for goods and services.

WE'LL ALL GAIN FROM CHINA'S WTO ENTRY

The escalating trade dispute between China and Japan is a sobering reminder of how disruptive China's rise as an economic power could be and how much the rest of the world has to gain from China's rapid entry into the World Trade Organization. Only by bringing China into a rules-based system is there hope of ensuring that it is a force for progress.

Fortunately, China and the U.S. have just announced they've settled the remaining disputes standing in the way of China's WTO entry. Concerted negotiations could see Beijing around the time a new round of trade talks kicks off in Qatar in November. The agreement marks a welcome pragmatism in both Beijing and Washington following the recent spy-plane incident. China, in particular, has toned down militaristic rhetoric to cut a pragmatic economic deal.

The WTO isn't going to solve all the problems between China and its trading partners. Tremendous social dislocation is in store for hundreds of millions of farmers and workers as state companies once markets are opened up and the world's global competition blow through deeply into China. But the world got it badly wrong a century ago as Germany and Japan clamored for a seat at the table of the rich and powerful, and didn't get it. We can't afford to make the same mistake with China. Rising trade tensions with Japan show it's time to fully integrate China into the world economy system.



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